2-5/24

Forecast what future of Labor Unions. Effect of decision on Labor unions & activities.

May 31st - 12 hrs.

June 1st 1 hr
5th 1 hr
7th 2 "
8th 1 "
9th 1½
12 ½

19 hrs.

Clara Louise Doerr
245 West 60th Street
Chicago, Illinois

Wentworth 7863.

MATERIALS FOR THE STUDY OF BUSINESS

Materials for the Study of Business

Industrial Society. By Leon C. Marshall. xxiv+1,082 pages, royal 8vo, cloth.

Financial Organization of Society. By H. G. Moulton. xxii+790 pages, crown 8vo, cloth.

Principles of Accounting. By Albert C. Hodge and J. O. McKinsey. xiv+390 pages, 8vo, cloth.

Law and Business. By William H. Spencer.

Vol. I. Introduction to Law and Business. xviii+612 pages, 8vo, cloth.

Vol. II. Law and the Market. Law and Finance. xviii+670 pages, 8vo, cloth.

Vol. III. Law and Labor. Law and Risk-Bearing. Law and the Form of the Business Unit. xviii+654 pages, 8vo, cloth.

Business Administration. By Leon C. Marshall. xxiv+920 pages, 8vo, cloth.

Social Studies in Secondary Schools. By a Commission of the Association of Collegiate Schools of Business. x+114 pages, 12mo, boards.

IN PREPARATION

Business Communication.
Risks and Risk-Bearing.
Managerial Accounting.
Bank Management.
Commercial Cost-Accounting.
The Manager's Administration of Finance.
The Place of the Market in Our Economic Society.
The Manager's Administration of the Market.
The Worker in Our Economic Society.
The Manager's Administration of Labor.
The Social Control of Business Activities.
Government and Business.
The Physical Environment of Business.
Traffic and Transportation.
The Psychology of Business Procedure.
Education for Business

THE UNIVERSITY OF CHICAGO PRESS
CHICAGO, ILLINOIS

LAW AND BUSINESS

THE UNIVERSITY OF CHICAGO PRESS
CHICAGO, ILLINOIS

THE BAKER & TAYLOR COMPANY
NEW YORK

THE CAMBRIDGE UNIVERSITY PRESS
LONDON

THE MARUZEN-KABUSHIKI-KAISHA
TOKYO, OSAKA, KYOTO, FUKUOKA, SENDAI

THE MISSION BOOK COMPANY
SHANGHAI

LAW AND BUSINESS

VOLUME III

LAW AND RISK-BEARING

LAW AND LABOR

LAW AND THE FORM OF THE BUSINESS UNIT

BY

WILLIAM H. SPENCER

THE UNIVERSITY OF CHICAGO PRESS
CHICAGO, ILLINOIS

COPYRIGHT 1922 BY
THE UNIVERSITY OF CHICAGO

All Rights Reserved

Published May 1922

Composed and Printed By
The University of Chicago Press
Chicago, Illinois, U.S.A.

EDITOR'S PREFACE

Collegiate training for business administration is now so widely attempted that the time has arrived when experiments should be conducted looking toward the organization of the business curriculum into a coherent whole. Training in scattered "business subjects" was defensible enough in the earlier days of collegiate business training, but such a method cannot be permanent. It must yield to a more comprehensive organization.

There can be no doubt that many experiments will be conducted looking toward this goal; they are, indeed, already under way. This series, "Materials for the Study of Business," marks one stage in such an experiment in the School of Commerce and Administration of the University of Chicago.

It is appropriate that the hypotheses on which this experiment is being conducted be set forth. In general terms the reasoning back of the experiment runs as follows: The business executive administers his business under conditions imposed by his environment, both physical and social. The student should accordingly have an understanding of the physical environment. This justifies attention to the earth sciences. He should also have an understanding of the social environment and must accordingly give attention to civics, law, economics, social psychology, and other branches of the social sciences. His knowledge of environment should not be too abstract in character. It should be given practical content, and should be closely related to his knowledge of the internal problems of management. This may be accomplished through a range of courses dealing with business administration wherein the student may become acquainted with such matters as the measuring aids of control, the communicating aids of control, organization policies and methods; the manager's relation to production, to labor, to finance, to technology, to risk-bearing, to the market, to social control, etc. Business is, after all, a pecuniarily organized scheme of gratifying human wants, and, properly understood, falls little short of being as broad, as inclusive, as life itself in its motives, aspirations, and social obligations. It falls little short of being as broad as all science in its technique. Training

BASIC ELEMENTS OF THE BUSINESS CURRICULUM

CONTROL

1. Communicating aids of control, for example
   a) English
   b) Foreign language
2. Measuring aids of control, for example
   a) Mathematics
   b) Statistics and accounting
3. Standards and practices of control
   a) Psychology
   b) Organization policies and methods

Of problems of adjustment to physical environment
   a) The earth sciences
   b) The manager's relationship to these

Of problems of technology
   a) Physics through mechanics, basic, and other sciences as appropriate
   b) The manager's administration of production

Of problems of finance
   a) The financial organization of society
   b) The manager's administration of finance

Of problems connected with the market
   a) Market functions and market structure
   b) The manager's administration of marketing (including purchasing and traffic)

Of problems of risk and risk-bearing
   a) The risk aspects of modern industrial society
   b) The manager's administration of risk-bearing

Of problems of personnel
   a) The position of the worker in modern industrial society
   b) The manager's administration of personnel

Of problems of adjustment to social environment
   a) The historical background
   b) The socio-economic institutional life
   c) Business law and government

for the task of the business administrator must have breadth and depth comparable with those of the task.

Stating the matter in another way, the modern business administrator is essentially a solver of business problems—problems of business policy, of organization, and of operation. These problems, great in number and broad in scope, divide themselves into certain type groups, and in each type group there are certain classes of obstacles to be overcome, as well as certain aids, or materials of solution.

If these problems are arranged (1) to show the significance of the organizing and administrative, or control, activities of the modern responsible manager, and (2) to indicate appropriate fields of training, the diagram on the opposite page (which disregards much overlapping and interacting) results. It sets forth the present hypothesis of the School of Commerce and Administration concerning the basic elements of the business curriculum, covering both secondary school and collegiate work.

These present volumes on *Law and Business* deal with one phase of the relationship of the business administrator to his social environment.

L. C. Marshall

AUTHOR'S PREFACE

These materials on *Law and Business*, presented in three volumes, are intended primarily for use in schools of business. They are prepared to serve as a basis of instruction in the legal aspects of business and are a part of a general collection of materials for the study of business. It is hoped, however, that they may be serviceable also to departments of political science and political economy.

In attempting to fit these materials into a coherent program of business education, I have kept in mind certain definite objectives which, in my opinion, should be sought for in the teaching of law in schools of business. These objectives have been worked out in terms of purposes and aims of business education in general.

Whatever else a school of business may have ambitions to do, it is now coming generally to be agreed that its most appropriate task is to instruct its students in the fundamental principles of business administration. In the nature of things, a school of business can do little or nothing in the technical aspects of business, because these aspects vary so greatly in different business activities. It can accomplish only slightly more in giving instruction in the administration of particular businesses. But underlying all forms of business activities there are certain fundamental principles of administration and management and it is to this field that the school of business must, for the most part, confine its activities. Effort has been made to present this point of view in the preparation of these materials on *Law and Business.*

This collection of materials is presented on the theory that a thorough study of them will assist the future business man in the administration of his business. A business man, for instance, should know something of accounting, not because he is going to be an accountant, but because he will not understand his business without a knowledge of it. Accounting is a form of control and a knowledge of it is an aid to administration. A business man should know some law, not because he is going to be a lawyer, but simply because he must have some appreciation of his relation to organized society in order to carry on his business intelligently and successfully. Law,

too, is a form of control and a knowledge of it is an aid to administration.

Speaking in general terms, the real purpose of teaching law in a school is, or should be, to bring to the future business man a certain awareness of the larger problem of social control. Whether he likes it or not, he must play the game according to the rules. He must therefore be brought to a realization that one of the conditions of carrying on business in our present economic order is that he submit himself and his business to the control of society. Law is one of the most important instrumentalities of social control and it is for this reason that students preparing for business should be given instruction in it.

More specifically, there are several objectives which should be reached by a proper presentation of these materials. (1) This study should introduce the student to the whole field of the law, give him a working knowledge of legal phraseology, and prepare him for the study of case material. (2) It should assist him in visualizing more clearly the structure of modern society, by showing him the part which law and legal institutions have played in its development. (3) The study should give the student a practical knowledge of the legal devices which business men use in the administration of their affairs. (4) It should give him an appreciation of certain portions of the law which directly and intimately throw around him the lines of social control. These rules of law, commanding this, prohibiting that, and permitting the other, are important because they mark out definite limits within which business men must formulate their policies. (5) It would seem not too much to hope that upon the completion of the study of these materials the student will have become fairly skilful in analyzing court decisions. This *desideratum*, if realized, should prove to be of the greatest value to the future business man. The power to analyze a court decision will not only open up and make available for him the whole field of reported cases but will also give him a certain mental outlook and resiliency which will aid him in adjusting himself to his social environment.

An arrangement, different from the orthodox arrangement of materials for the study of law, has been adopted in the preparation of these materials. This has been done consciously with the conviction that if the teaching of law is to justify its place in the curriculum of the school of business it must be less and less law after the traditional order and more and more business after the modern view. If the

key word of business education is *administration*, and if the purpose of teaching law to the business student is to assist him in mastering the principles of administration, then it would seem that the law for him, at least, should be worked out in terms of functions, relations, or problems of the business man, and not in terms of the order in which the law has developed. The arrangement, therefore, of the content of these materials on *Law and Business* has been made on a functional basis—in terms of business problems or relations, as far as this has been possible and feasible.

The functional materials have been preceded by introductory materials to which the first volume is devoted. The purpose of these is: first, to introduce the student to the whole field of the law by giving him a certain background of jurisprudence, a working knowledge of how rights are enforced, and some appreciation of the analysis of cases; second, to furnish the student with fundamental legal concepts from persons, torts, contracts, agency, and property, in preparation for the study of the functional materials which follow in later volumes; and third, incidentally to give him an appreciation of the place which law occupies in the structure of modern society. These materials are, as their name implies, an introduction to the study of *Law and Business*.

The materials which follow the Introduction are worked out in terms of the various relations or functions which seem typically characteristic of all forms of business. The first division of these materials deals with the law as it affects the business man's relation to his market. What are the legal devices which a business man may resort to in the administration of his market activities? What are the legal limitations on the choice of his market policies and practices? The second division treats of the legal problems involved in the administration of the business man's finances. What are the legal devices which assist him in getting money and credit? What are the legal devices for securing creditors? What are the remedies of creditors against their debtors? The third division deals with the law relating to risk-bearing as a function in business. To what extent does the law sanction the shifting of risks? What devices does the law furnish for the shifting of risks? The fourth division deals with the legal aspects of the business man's relation to his labor. What are the outstanding characteristics of the common-law contract of employment? What are the rights of the employer in competition with rival employers for labor? What are the rights of the employer in

competition with his employees for terms of employment? How have the various problems been dealt with in modern labor legislation? The fifth division of the materials deals with the law relating to the form of the business unit. What organization devices does the law recognize and sanction? What are the characteristics of these various organization devices? How are the various organizations formed, dissolved, and reorganized? How are they controlled, externally and internally? How are they financed?

The first volume of the materials on *Law and Business* is devoted to an Introduction to the study of *Law and Business*. The materials in the second volume deal (1) with the legal aspects of the business man's relation to his market and (2) with the legal aspects of the business man's relation to his finances. The materials in this, the third volume, deal (1) with the legal aspects of the business man's relation to risk and risk-bearing, (2) with the legal aspects of the business man's relation to his labor, and (3) with the legal aspects of the business man's relation to the form of his business unit.

In conclusion, something should be said concerning the methods of instruction contemplated in the preparation of these materials. Perhaps more materials have been selected than any school can adequately consider in the time allotted by the curriculum to the study of law. This, however, has been done consciously and deliberately. The fact that excess material is placed in the hands of the student will be of distinct value even though it cannot be treated in class discussion. It will tend to develop in him a spirit of research which at present is sadly lacking not only in schools of business but in law schools as well. Moreover, this excess material will afford teachers some latitude in the choice of the material which they wish to use and in the subject-matter which they wish to cover.

It is very strongly felt that the study of law in schools of business should be largely inductive and should be based on case material as far as possible. Accordingly, these materials are composed for the most part of reports of leading cases. They have been carefully selected with a view both to their pedagogical qualities and to their business content. Each case has been stripped of its nonessential features for economics in time and space, but not to such an extent, it is hoped, that the didactic character of the case has been dissipated in the process of adaptation.

Each case or unit of material is followed by a series of questions and problems. These are typically of the following kind: (1) ques-

tions which serve to bring out the technical aspects of the principal case; (2) hypothetical cases which are intended to develop the doctrine of the principal case; (3) hypothetical cases which involve corollaries of the principal case; (4) questions and cases which connect the principal case with past cases and anticipate problems in future cases; (5) exercises which encourage investigation of statutory changes in the common law; and (6) exercises which encourage the examination and drawing of forms.

Definite and beneficial results should flow from the use of these exercises, questions, and cases. They will encourage the student to do collateral reading on portions of the subject which are not covered by the materials and which cannot be discussed in the classroom. Their use will assist the student in getting at the heart of a case by stimulating him to do much of his thinking before he comes to class. The questions and cases will serve as convenient devices for getting problems quickly before the class for discussion. The exercises will be useful in directing the student to investigate statutory changes and in assigning practical work.

I am conscious of the many imperfections of the present attempt to present materials for the functional study of law in schools of business. However, I keenly feel the need of materials with such an approach and believe that the present attempt is a step in the right direction, and that for the present they will fill a growing need in colleges and universities in the study of business.

I wish to take this opportunity of expressing my gratitude to Professor Herman Oliphant, of the Law School of Columbia University, formerly of the Law School of the University of Chicago, for the aid and advice which I received from him in the preparation of these materials. My debt of gratitude to Dean L. C. Marshall, of the School of Commerce and Administration of the University of Chicago, for his help in working out the functional approach to the study of law in schools of business is no less great. I wish also to express my appreciation to Mr. J. F. Christ, of the University of Chicago, for his assistance in preparing these materials for publication.

W. H. Spencer

Chicago, Illinois
April 3, 1922

TABLE OF CONTENTS

LAW AND RISK-BEARING

PAGE

CHAPTER I. INTRODUCTORY TOPICS 3

CHAPTER II. DEVICES FOR SHIFTING RISKS 10

1. In General 10
2. Speculative Contracts 13
3. Contracts of Insurance 22
   a) In General 22
   b) The Insurable Interest 26
   c) Concealment, Misrepresentation, and Fraud 52
   d) Operation of the Contract of Insurance 68
      i. As to Parties 68
         I) Assignees 68
         II) Beneficiaries 76
      ii. As to Obligation 86
         I) The Risk Insured Against 86
         II) Warranties 102
         III) Conditions 111
         IV) Amount of Recovery 129
   e) Insurer's Right of Subrogation 135

LAW AND LABOR

CHAPTER I. INTRODUCTORY TOPICS 145

CHAPTER II. THE RELATION OF EMPLOYER AND EMPLOYEE . . . 150

1. The Contract of Employment 150
2. Liability of Employer for Injuries to Employees 164
   a) Under the Common Law 164
      i. Risks Assumed by the Employee 164
      ii. Risks Not Assumed by the Employee 181
   b) Under Modern Legislation 190
      i. In General 190
      ii. Compensable Injuries 204

CHAPTER III. COMPETITIVE LABOR PRACTICES 217

LAW AND THE FORM OF THE BUSINESS UNIT

PAGE

CHAPTER I. INTRODUCTORY TOPICS 281

CHAPTER II. NATURE AND CHARACTERISTICS OF FORMS OF THE BUSINESS UNIT 284

CHAPTER III. FORMATION OF THE BUSINESS UNIT 327

1. Promotion of the Unit 327

2. Organization of the Unit 337

CHAPTER IV. FINANCING THE BUSINESS UNIT 369

1. In General 369

2. Devices for Raising Capital 386

3. Inducements to Investors 403

a) Transferability of Interest 403

b) Participation in Management 412

c) Participation in Profits 422

CHAPTER V. MANAGEMENT OF THE BUSINESS UNIT 432

1. Keeping the Unit within Its Powers 432

a) Powers of the Unit 432

b) Effect of Exceeding Powers 458

2. Distribution of the Powers of the Unit 467

a) Powers of the Majority 467

b) Powers of Individual Members 503

c) Powers of Representatives 536

3. Duties of Members and Representatives in Management . 545

CHAPTER VI. RESPONSIBILITY FOR TORTS AND CRIMES . . . 575

CHAPTER VII. ADJUSTMENT OF THE RIGHTS OF CREDITORS . . . 589

CHAPTER VIII. DISSOLUTION OF THE BUSINESS UNIT 619

TABLE OF CASES 645

INDEX 649

LAW AND RISK-BEARING

CHAPTER I

INTRODUCTORY TOPICS

A

Another of the many important relations which a business man must face in the administration of his business arises in connection with the risks to which he and his business are constantly exposed. It matters not how careful, far-sighted or sagacious he is, it is inconceivable that he will be able to escape entirely the hazards of the world and society in the affairs of which he is actively engaged.

What is the nature of this phenomenon which we are calling a *risk?* It is something which may or may not result in a loss to one. This something may be the happening or the non-happening of an uncertain, future event. The occurrence or non-occurrence of the event may or may not be foreseeable from the standpoint of a reasonable person. The consequences of the happening or non-happening may or may not be avoidable by the exercise of reasonable care. These, then, are the more significant features of the thing which we are here calling a *risk.*

Some of the risks to which the business man and his business are exposed are those arising from the operation of natural causes, and over which he has relatively little control. As examples of this class of risks, we may mention storms, earthquakes, and floods, which in law are usually referred to as "Acts of God" because of their inevitable and unavoidable character.

Another class of risks has its origin in the conduct and actions of human beings. Some of these arise out of the natural weakness and criminal instincts of mankind. Health, life, social and economic relations, and property are constantly menaced by the practices of criminals and of those criminally inclined. Swindlers, embezzlers, thieves, robbers, forgers, incendiaries, and murderers regularly take their toll from the wealth of society.

Closely akin to the foregoing risks are those which arise from the negligent conduct of human beings. A man is said to intend an injurious result when he foresees, desires, and strives for its consumma-

tion. He is said to be negligent as to an injurious result when he foresees it and yet proceeds in his course of action, regardless of consequences, even though he may hope and desire that the injurious result will not occur. Wastage and destruction of property, early and premature deaths, and business failures are in a very large degree due to the inherent indifference of mankind to foreseeable consequences.

Accidental or non-negligent injuries constitute yet another human source of risks to which every person and his affairs are subject. An injurious result is said to be accidental or non-negligent when it is not reasonably foreseeable by the actor at the time he does the act which produces the result. The difference between negligent and non-negligent conduct, it will be observed, is one of degree. Whether a given injurious result is to be treated as negligent or accidental depends upon the standard of care which the law demands of the actor. But however this may be, the fact remains that life, property, and social and economic relations are, and probably will always be, exposed to a great variety of risks from the non-negligent or accidental conduct of human beings.

There is yet a third class of risks to which the business man is subject—risks which arise out of fundamental or organic changes in society itself. Social wants are not constant but are ever changing both in kind and in quantity. Every person, therefore, who performs services or produces goods for society, does so at his peril. A change in wants may overnight render valueless his skill, capital investment, or goods which he has already produced. Changes in modes of production, inventions and increased efficiency in management all mean that those who, through choice or necessity, continue the use of old methods, devices, and ways of doing things must suffer. It may very well be that society as a whole will profit in the long run by the new methods and devices, but the fact remains that the individual must suffer some loss unless he can foresee the changes and take steps to avoid their consequences.

This is but a general statement of the risks and hazards to which a person carrying on a business is subjected. The problem of the business man in relation to these risks and hazards has several aspects. In the first place, he should acquire as much knowledge as possible concerning the nature and character of the risks to which he is exposed. In the second place, he should take steps to prevent the materialization of all those losses which are in their nature avoidable by the exercise of reasonable care and diligence. Finally, he should prepare

to meet and lessen the shock of unavoidable risks or resort to one device or another for the purpose of shifting them to someone else.

The problem of the business man in connection with risk and risk-bearing has many legal implications, a knowledge of which will be of distinct benefit to him in the administration of his affairs. A study of these legal implications should reveal to him the principles and policies of the law underlying the placement and distribution of losses resulting from the various risks to which he is exposed. The study should give him some appreciation of the extent to which he can legally shift his risks to other persons. Finally, it should give him a working knowledge of the legal devices by which this shifting of risks can be accomplished.

B

What are the considerations involved when it is asked whether one can legally shift the risk of future losses to another? Are there any reasons of public policy which forbid one person to assume another's risks? Are there any social advantages to be gained by permitting this to be done? The answers to these questions will depend upon the character of the risks and the relation of the parties. May one person contract to indemnify another against the consequences of crimes which the other may commit? May one contract to furnish another all the coal the latter may need in his business for a year? The two situations represent opposite extremes in shifting risks and the answer to each is simple. But lying between these extremes there are doubtful cases which are not so easily solved.

It may be urged that any agreement by which one person shifts his risks to another is a gambling transaction and, in law, unenforceable. Let us examine this position. A risk, as has been pointed out in another connection, is something which may or may not materialize in a loss. If, therefore, one person assumes the risk of another for a consideration, is he not in fact wagering upon the happening or non-happening of an uncertain event? Is not this a gambling transaction? Gambling transactions, the law refuses to enforce. They tend to corrupt the morals of the community, so it is alleged, in that they engender and foster an unwholesome spirit of getting something for nothing. But even if they do not tend to corrupt the morals of the community, they certainly serve no useful social purposes; and it would be an unwarranted waste of social energy to put in motion our expensive legal machinery for their enforcement. The issue,

then, is squarely presented, Is an assumption by one of the risks of another essentially a gambling transaction? In law we are accustomed to think of a gambling transaction as one in which one person promises to give another money or something of value, upon the happening or non-happening of an uncertain event, in which neither has any interest. In such a situation, by hypothesis, the promisee has nothing to protect. There is no possible loss which is likely to fall upon him. In other words, there is an entire absence of any risk to which he is exposed. He either gets something for nothing or he gives something for nothing. But in these cases of risks, which we shall be considering, the promisee does have a real vital interest to protect. He wishes to avoid the happening of an uncertain event—a loss to himself or his property. What then is the situation if someone else, for a consideration, promises to assume his risks? Whether the loss happens or not, he has had his protection. In neither case has he received something for nothing. If a loss happens, he gets positive protection. If the loss does not happen, he has had negative protection. On the other hand, in both cases, the promisor has been paid for giving the protection.

Again, it may be urged, and one thinks very forcibly, that the result of permitting a person to shift his risks to another, is to lower appreciably the standards of care which are normally exercised over life and property. There is only so much social energy in the world and we are coming more and more to realize that it is all needed to meet the wants of society. It should, therefore, be a constant care with every person to reduce his losses to a minimum. To the extent that forms of vicarious risk-bearing place a premium upon low standards of care over life, property, and social energy generally, to that extent risk-bearing is socially undesirable. If the necessity of immediately facing and bearing one's losses in full is removed, one of the most powerful of all incentives toward a high degree of care is taken away. It is, of course, impossible to estimate with any degree of accuracy, how far modes, by which risks can easily be shifted, result in social waste and destruction, but it is almost universally agreed that there is an ever-increasing tendency in this direction.

In so far as the shifting of risks is permissible in law, are there no safeguards which are operative to check this unwholesome tendency toward lower standards of care? In theory, if not in fact, every person pays in full for the losses he suffers, and, in addition, for the

services which others perform in carrying the risks of his losses. If society as a whole is temperamentally negligent and careless, obviously enough, risks are increased; and the price which the individual must pay for protection against losses is proportionately higher. As every member of society profits by a decrease in risks and losses, so every member must in one way or another pay the price of an increase in them. But this fact is not alone sufficient to counteract the tendency toward lower standards; and the reason is that the losses are spread so evenly over the whole of society that the individual is scarcely conscious of the fact that he is bearing his share of the burden. The vision of the average individual does not reach that far into the future. He does not realize that he must pay his share of the losses and that he must pay according to the prevailing social standards of care. Because of this short-sightedness of the average individual, a higher or lower premium is placed upon negligence and indifference to consequences, depending upon the ease with which risks may be shifted to others.

Against this tendency toward lower standards of care over life and property, there is another safeguard which, though sound in theory, does not always work well in practice. Underlying most forms of risk-bearing, sometimes patent and sometimes obscure, there is the theory of indemnity. This principle, which runs more or less unevenly through the portions of the law dealing with risks, is that the individual shall not be entitled in any event to receive from the risk-bearer more than his actual loss. But this theory is not always a sufficient safeguard against the evil in question. In some cases, due to the inherent nature of the risk, it is difficult, if not impossible, to place any accurate or rational valuation upon the loss. Who, for instance, is able to say how much a human life is worth in dollars and cents? In other cases, due to the imperfections of our legal machinery, it is not always possible to disprove a prima facie loss, because the evidence of the value of the subject-matter, after the loss has occurred, more than often lies peculiarly within the knowledge of the individual.

But on the other hand, the power to shift one's risks results in certain clear gains to society, which in the long run, according to our present best thinking, more than outweigh the evil tendencies of which we have been speaking. There is an ever-increasing class of persons who make it their business to assume the risks of others. These persons in their business make a very careful study of the forms of risks in which they are interested; though the study is pri-

marily for their own use in predicting the probabilities of loss, yet, at the same time, the data they collect and the results of their investigation furnish valuable assistance to those who wish to avoid the consequences of their risks and not merely to shift them.

Again, these professional insurers assume the losses as they occur and spread them evenly over a large number of people and a relatively long period of time. In doing this, they perform distinctly valuable services not only to the individual but to society as a whole. It is a service to the individual in that it relieves him of the necessity of meeting the whole of his losses as they occur. The average individual is scarcely able to carry his own risks without great peril to himself. One severe and unexpected blow may prove his financial undoing. Five men can bear their aggregate risks more easily and with less serious consequences than one can bear his individual risks. One hundred men can do the same thing still more easily. This theory underlies all forms of indemnification: the greater the concentration of risks, the more evenly the losses can be spread and the more lightly the burden carried. This spreading of risks is also a service to society as a whole in that it prevents what might otherwise be far-reaching consequences from an individual loss. Our present industrial society is a highly interdependent organization; and what prejudicially affects one member of it will more than likely affect others in the same way. A severe shock does not always stop with the individual sufferer; it is very frequently communicated to others; and, like a conflagration, it gains in intensity as it spreads. Those who are engaged in the business of indemnification are in reality shock-absorbers and perform valuable services in localizing shocks and in arresting the train of consequences from them, causing damage to society in general and additional damage to the individual.

C

Our final question relates to the legal transactions or devices by which the individual can shift his risks to someone else. Fundamentally, all forms of risk-bearing arise out of a contract of one kind or another. No person is under any duty, against his will, to indemnify another against losses. And even though he voluntarily promises to assume another's risks, his undertaking is not legally binding upon him, unless the promisee has furnished a consideration to support the promise. A contract is, therefore, the sole legal device by which the promisor can irrevocably bind himself to bear the losses of another.

This risk-bearing contract may appear in one of a great many forms. But in this connection only passing reference to certain types need be made. It is sometimes said that one effect of every executory contract is to shift risks from one contracting party to another. An executory contract, in its final analysis, is the purchase by one person of the future conduct of another. By making the contract, the former evidences his desire for the latter's conduct; and the contract gives him the assurance that he will get it or its equivalent in damages. To this extent, and in this sense, any executory contract is, at least incidentally, an indemnity transaction.

There are types of contract, however, the primary purpose of which is to shift risks. A enters into a contract with B, by the terms of which B agrees to release A from liability for all injuries which he may suffer from A's negligence. This is an express attempt on the part of one person to shift the risks of his own wrong-doing to the very person likely to be injured by it. P enters into a contract with C, promising to pay D's debt, or promising to answer for D's debt, default or miscarriage. In either event, P by contract is assuming the risk of D's failure, refusal, or inability to pay his own debts. By far the largest and most important class of risk-bearing contracts is that made up of insurance contracts. These are almost as numerous as the risks to which life and property are exposed. Insurance against lightning, hail, storms, floods, death, accident, bad debts, may be mentioned as examples of the various and diverse types of insurance. Because of their importance and because they involve fundamentally the same principles which underlie all forms of risk-bearing, most of our attention in this connection will be devoted to fire and life insurance contracts.

CHAPTER II

DEVICES FOR SHIFTING RISKS

1. In General

CRANE *v.* CRANE & COMPANY

105 Federal Reporter 869 (1901)

This was an action by the plaintiff, who was a manufacturer of lumber, to recover a balance due for lumber sold and delivered to the defendant, who was a dealer in lumber. Against this action the defendant sought to recoup or set off the damages alleged to have been suffered by him, in the failure of the plaintiff to fill three orders relating to dock oak lumber of the dates of October 19, 1897, January 31, 1898, and April 8, 1898. It was insisted by the defendant that in December, 1896, he made a contract with the plaintiff, by the terms of which the latter was to furnish the former all the dock oak that the former would require for their trade in the Chicago market during the year 1897, at certain prices not in dispute, and that this contract was broken in the failure of the plaintiff to fill the order of October 19, 1897. It was insisted, also, that in January, 1898, a like contract was made for the year 1898, except that the price was to be one dollar per thousand feet in excess of the prices for the preceding year, and that this contract was broken in the failure to fill orders of January 1, 1898, and April 8, 1898, respectively.

GROSSCUP, CIR. J. The question lying at the threshold of this case is whether the so-called contract of December, 1896, relating to the sale of dock oak lumber for the year 1897, and the so-called contract of January, 1898, relating to the same subject for the year 1898, are enforceable.

The contention is that both are void for want of mutuality.

It is within the legal competency for one to bind himself to furnish another with such supplies as may be needed during some certain period for some certain business or manufacture; or with such commodities as the purchaser has already bound himself to furnish another. Reasonable provision in business requires that such contracts, though more or less indefinite, should be upheld. Thus a foundry may purchase all the coal needed for the season; or a furnace

company, its requirements in the way of iron; or a hotel company, its necessary supply of ice. *Minnesota Lumber Co.* v. *Whitebreast Coal Co.*, 160 Ill. 85, 43 N.E. 774; *National Furnace Company* v. *Keystone Mfg. Co.*, 110 Ill. 427; *Railway Co.* v. *Latham*, L.R. 9 C.P. 16; *Smith* v. *Morse*, 20 La. Ann. 220. So, too, a dealer in coal in a given locality may contract for such coal as he may need to fulfil his existing contracts, regardless of whether delivery by him to his customers is to be immediate or in the future. *Shipman* v. *Mining Company*, 158 U.S. 356. In all these cases, contracts looking toward the future, and embodying subject-matter necessarily indefinite in quantity, have been upheld; but it will be observed that, although the quantity under contract is not measured by any certain standard, it is capable of an approximately accurate forecast. The capacity of the furnace, the needs of the railroad, or the requirements of the hotel are, within certain limits, ascertainable by the vendor. He is thus enabled to make reasonably accurate calculation of the extent of his obligation. Then, too, the purchase is only an incident of the vendee's business. Presumably the business will go on irrespective of a rise or fall in the prices of subsidiary supplies. There thus remains to the vendee little or no temptation, on account of the rise or fall in prices, greatly to enlarge or diminish the quantity of his orders.

The contracts brought to our attention have no such standard of approximate certainty, and no such safeguard against opportunity to impose upon the vendor. The defendant was at the time engaged in no manufacture or business that required dock oak lumber as an incidental supply, nor was he under any contract to deliver such lumber to third persons at fixed prices. He was a lumber merchant pure and simple—a middleman between the plaintiff, and such customers as usually come to a merchant. Should the contract under discussion be upheld, the defendant would be held to occupy this advantageous position: If the prices of dock oak lumber rose, he would, by that much, increase his ratio of profits, and probably, coming into a situation to outbid competitors, increase, also, the *quantum* of orders; if, on the other hand, prices fell below the range of profits, the orders could be wholly discontinued. On the contrary, the situation of the plaintiff would be this: Should prices fall, it could not compel the defendant to give further orders; but, should prices rise, the orders sent in would be compulsory, and the loss measured, both by the increase of the ratio of profits, and the probable

increase of orders. It is needless to say that such a contract is unilateral, and void for want of mutuality. It, in effect, binds the plaintiff alone, for it leaves the defendant—whose sole interest is embodied in the prices obtainable—in a situation either to go on or to discontinue, as such interest develops.

QUESTIONS

1. Was the contract held bad in the principal case because it was a wagering contract? What is a wagering contract? Why do courts refuse to enforce them?
2. It is said that business men enter into executory contracts to protect themselves against the uncertainties of the future. How does an executory contract protect one in this respect? Does such a contract remove the uncertainties or shift them?
3. The court felt pretty strongly that the contract under consideration in the principal case was not fair to the plaintiff. Does it appear that any fraud was practiced on him? If not, is it the function of the courts to assist a party in extricating himself from a hard bargain into which he has gone with his eyes open?
4. D offers to sell P all the coal he may order during the year 1922. P replies that he accepts the offer. P places an order in 1922 which D refuses to fill. P sues D for damages. What decision?
5. P offers to sell D all the iron he may need in his foundry business during the year 1922. D accepts the offer. During the year D buys iron from X. P sues D for damages. What decision?
6. P, a miller, contracts to buy 10,000 bushels of wheat from P, a dealer in wheat, at $1.25 a bushel, to be delivered in instalments during the year 1922. Because of an unusual rise in prices, D refuses to deliver any wheat in performance of the contract. P sues D for damages. What decision?
7. C advances $5,000 to D. P, for a consideration, guarantees the repayment of the debt. What is the effect of this contract? It protects C, of course, but against what does it protect him?
8. A brewing company enters into a contract with P, by which it promises, in consideration of P's promise to sell the company's brew exclusively, to indemnify him against all consequences of his violations of the prohibition laws. P sues the brewing company on the contract. What decision?
9. P sues D, his employer, for damages caused by the negligence of D. D pleads in defense a contract by which P agreed for a consideration to release him, D, from all liability for injuries caused by his negligence. What decision?

2. Speculative Contracts

HIBBLEWHITE *v.* M'MORINE

5 Meeson & Welsby's Reports 462 (1839)

Debt.—The first count of the declaration was upon an agreement made between the plaintiff and the defendant, on the tenth of September, 1838, for the sale by the plaintiff to the defendant of fifty shares in the Brighton Railway Company, to be transferred, delivered, and paid for, on or before the first day of March, 1839, or at any intermediate date that the defendant might require them, by paying the plaintiff for the said shares at par per share, together with all calls that might have been paid on the same, etc. The count averred mutual promises, that the plaintiff was ready and willing to transfer and deliver the shares to the defendant, if he would have paid for the same, and that he would have offered him a legal transfer of the shares but that the defendant did not nor would accept and pay for the said shares, but altogether refused so to do, etc.

The defendant pleaded, sixthly, as to the first count of the declaration, *actionem non*, because he says, that at the time of the making of the agreement therein mentioned, and of the mutual promises therein mentioned, he, the plaintiff, was not possessed of nor entitled to the said fifty shares in the Brighton Railway Company, in the said first count mentioned to have been purchased by the defendant from the plaintiff, or any of them, nor had the plaintiff at that time entered into any contract for the purchase of such fifty shares, or any of them, nor had he at that time any reasonable expectation of becoming possessed of or entitled to any such shares within the time by the said agreement for the fulfilment thereof by the plaintiff, otherwise than by his, the plaintiff's, purchasing such shares after the time of making the said agreement. Verification. General demurrer and joinder.

PARKE, B. I have always entertained considerable doubt and suspicion as to the correctness of Lord TENTERDEN'S doctrine in *Bryan* v. *Lewis;* it excited a good deal of surprise in my mind at the time; and when examined, I think it is untenable. I cannot see what principle of law is at all affected by a man's being allowed to contract for the sale of goods, of which he has not possession at the time of the bargain, and has no reasonable expectation of receiving. Such a contract does not amount to a wager, in as much as both the contracting parties are not cognizant of the fact that the goods are not in the vendor's possession; and even if it were a wager, it is not illegal,

because it has no necessary tendency to injure third parties. The dictum of Lord TENTERDEN certainly was not a hasty observation thrown out by him, because it appears from the case of *Lorymer* v. *Smith* that he had entertained and expressed similar notions four years before. He did not, indeed, in that case say that such a contract was void, but only that it was of a kind not to be encouraged; and the strong opinion he afterward expressed appears to have gradually formed in his mind during the interval, and was no doubt confirmed by the effects of the unfortunate mercantile speculations throughout the country about that time. There is no indication in any of the books of such a doctrine having ever been promulgated from the Bench, until the case of *Lorymer* v. *Smith*, in the year 1822; and there is no case which has been since decided on that authority. Not only, then, was the doubt expressed by BOSANQUET, J., in *Wells* v. *Porter*, well founded, but the doctrine is clearly contrary to law. This plea, therefore, is bad in substance, and it is unnecessary to consider whether it be bad in form.

ALDERSON, B. I am of the same opinion. I think the dictum of Lord TENTERDEN cannot be supported. There is no principle in its favour. It would put an end to half the contracts made in the course of trade. Suppose a vendor makes a contract for the delivery of goods, which may be performed by the delivery of any goods of the kind bargained for; whether he has them in his possession at the time of the contract or not, can make no material difference, if he has them ready to be delivered at the time when the contract is to be fulfilled. I disclaim deciding on the ground of public policy; the policy of one man is not the policy of another, and such a consideration only tends to introduce uncertainty into the law.

MAULE, B. I am of the same opinion. I always considered the doctrine laid down in *Bryan* v. *Lewis* as contrary to law, and most inconvenient in practice; and I have often heard it spoken of with great suspicion, both by lawyers and mercantile men, upon both grounds—as against law, and against all mercantile convenience. It was with great surprise I heard so accurate a lawyer give utterance to a doctrine so evidently erroneous; but my surprise is much diminished by the circumstances to which Mr. Tomlinson has drawn our attention, and by reference to the case of *Lorymer* v. *Smith*, from which it appears that the opinion gradually formed itself in his mind, not so much from considerations of law as of mercantile convenience—of which he was not, perhaps, so good a judge—until at length he

expressed it so confidentially. I have no doubt, however, that it is erroneous, and therefore that this plea must be disallowed.

Judgment for the plaintiff.

QUESTIONS

1. D contracts to sell P ten shares of stock at $90 a share, to be delivered sixty days from the date of the making of the contract. In an action by P against D for breach of this contract, D contends that the contract is illegal because he had no such stock when he entered into the contract. What decision?
2. Suppose that D's defense, in the foregoing case, is that at the time he made the contract he not only had no such stock but that, to P's knowledge, he had no reasonable expectation of getting any such stock. Would this alter the decision?
3. In case No. 1, at the time set for performance, the market value of the stock is $100 a share. What is the measure of P's damages in an action against D?
4. D enters into a contract to sell P all the corn he may raise during a certain season at $1.75 a bushel. At the time D has not even planted his corn crop. P sues D for breach of the contract. What decision?
5. It is said that a contract like the one in the foregoing case is a form of protection to P. How does it protect him. Against what does it protect him?
6. In question No. 4, how can D protect himself?

KIRKPATRICK *v.* BONSALL

72 Pennsylvania State Reports 155 (1872)

AGNEW, J. We cannot pronounce this agreement a gambling contract on the fact of the writing. A bargain for an option, such as it presents, may be legitimate, and for a proper business object. We can imagine such cases. But it is evident such agreements can be readily prostituted to the worst kind of gambling ventures, and therefore its character may be weighed by a jury in connection with other facts in considering whether the bargain was a mere scheme to gamble upon the change of prices. The form of the venture when aided by evidence may clearly indicate a purpose to wager upon a rise or fall in the price of oil at a future day, and not to deal in the article as men usually do in that business. We must not confound gambling, whether it be in corporation stocks or merchandise, with what is commonly termed speculation. Merchants speculate upon the future prices of that in which they deal, and buy and sell accordingly. In other words they think of and weigh, that is, speculate upon, the

probabilities of the coming market, and act upon this lookout into the future, in their business transactions; and in this they often exhibit high mental grasp, and great knowledge of business and of the affairs of the world. Their speculations display talent and forecast, but they act upon their conclusions and buy or sell in a bona fide way. Such speculation cannot be denounced. But when ventures are made upon the turn of prices alone, with no bona fide intent to deal in the article, but merely to risk the difference between the rise and fall of its price, the case is changed. The purpose then is not to deal in the article, but to stake upon the rise or fall of the price. No money or capital is invested in the purchase, but so much only is required as will cover the difference—a margin, as it is figuratively termed. Then the bargain represents not a transfer of property, but a mere stake or wager upon its future price. The difference requires the ownership of only a few hundred or thousands of dollars, while the capital to complete an actual purchase or sale may be hundreds of thousands or millions. Hence, ventures upon prices invite men of small means to enter into transactions far beyond their capital, which they do not intend to fulfil, and thus the apparent business in the particular trade is inflated and unreal, and like a bubble needs only to be pricked to disappear, often carrying down the bona fide dealer in its collapse. Worse even than this—it tempts men of large capital to make bargains of stupendous proportions, and then to manipulate the market to produce the desired price. This, in the language of gambling speculation, is making a corner—that is to say, the article is so engrossed or manipulated as to make it scarce or plenty in the market at the will of the gamblers, and then to place its price within their power. Such transactions are destructive of good morals and fair dealing, and of the best interests of the commodity. If the article be stocks, corporations are crushed and innocent stockholders ruined to enable the gambler in its price to accomplish his ends. If it be merchandise, e.g., grain, the poor are robbed and misery engendered.

These remarks perhaps contain nothing new, but they are made to show how a contract, legal on its face, may become an instrument of illegal and ruinous schemes, injurious to the community and contrary to the highest policy of the state. The illegal purpose is therefore a fact falling within the province of the jury, and when found by them brings the contract under the ban of the law. If this purpose or intent be nothing but to wager on the rise or fall in the price of an

article, and not to deal in it bona fide, the law must pronounce the bargain a gambling contract. This brings us to consider the defendants' offer of evidence which the court refused.

Every offer of testimony is to be judged of by the court upon the state of the evidence already in, or of that with which the offer is proposed to be followed. How then did this case stand when the offer was made? The plaintiff had given in evidence a written agreement, not illegal, it is true, on its face, but of that kind used in gambling ventures. The defendants had shown by the plaintiff's own testimony that he was not a refiner of oil, or one who would buy for his own consumption—that he had not sold the oil when he made use of his call or option and therefore had no contract of his own to fulfil—and also that he did not intend to call for the oil if the market price had gone below the price fixed in the agreement. What intent would reasonably be inferred from these circumstances? Certainly the belief induced is that there was not an intent to bargain for oil for a real business purpose. Now if besides this contract it could be shown that many others of a similar kind were entered into by the same man, at and about the same time, certainly it would strengthen the conviction that the plaintiff was not a bona fide contractor in a legitimate business; and if we then add to this the fact that he was financially unable to take and pay for the total amount of oil he had contracted for, that conviction would become more firm, and that the real nature of his contracts was a wager on the rise and fall of the price of oil. The offer went therefore to the very question whether he was gambling in the price of oil. The objection to the offer that it was not of the time of the transaction is not tenable, for this agreement bears date the 15th of November, 1870, and the contracts offered to be shown were those to mature on or prior to the 1st day of January, 1871. They were therefore not too distant in time to have a bearing upon the character of the contract in question. The objection that these contracts would throw no light on the issue is plainly not valid, for the similarity of the contracts and the proximity of time considered with the financial inability of the plaintiff to fulfil them all, are not slight evidence merely of the wagering intent. It is no good answer that the plaintiff had stated his ability to control the means of performing his contract, for the defendants were not bound by his statement.

Had the evidence been received, and had the jury been satisfied of the truth of it, the case presents that of a man not

engaged in the oil business proper, bargaining for an immense quantity of oil far beyond his ability to pay for, with no intent to consume, use or sell it, entering into a similar contract precisely adapted to a wager on the price, and with no intent to call for a delivery of the oil unless the changes of the price fell out in his favor. This presented a question of fact for the jury, and not merely the legal interpretation of the paper on its facts, as a wagering contract. The rejection of the offer was therefore error.

Judgment reversed and a *venire facias de novo* awarded.

QUESTIONS

1. This was an action by the plaintiff against the defendants for a breach of contract to sell oil in the future. The court below gave judgment for the plaintiff. This judgment was reversed on appeal. Why was it reversed?
2. What is meant by dealing in stock "on margins"? Is a transaction on "margins" essentially a gambling transaction? Is the fact that one buys and sells "on margin" evidence that one is gambling?
3. What is meant by selling "short"? Is selling "short" per se a gambling transaction? Is selling "short" evidence of a gambling transaction?
4. What difference did it make in the principal case that the plaintiff was not a refiner of oil? That the plaintiff was financially unable to have taken and paid for all the oil he contracted for?
5. What test, if any, did the court lay down for determining the validity of a speculative contract?
6. D engages A, an agent, to buy and sell stock on the stock market and promises him a commission for his services. To A's knowledge, D intends neither to deliver nor to receive stock in performance of his various contracts. A sues D for his commissions. What decision?

TAYLOR *v.* HOWARD

192 Pennsylvania State Reports 304 (1899)

The auditor, Francis Shunk Brown, Esq., reported on the claim of William H. Howard as follows: H. C. Todd, Esq., presented claim of William H. Howard for $11,921.62. Mr. Howard is a capitalist and a farmer. On March 13, 1893, he bought 100 shares of Lehigh Coal and Navigation Company for $4,337.50, and the next day paid L. H. Taylor & Company $2,000. During the month of April, 1893, he appears to have ordered, bought, and sold about 1,200 shares of stock. On April 30, 1893, he ordered sold "short" 100 shares of Baltimore and Ohio Railroad Company and 100 shares of Phila-

delphia, Reading and New England Railroad Company. On July 31, 1895, he owed Taylor & Company, $50,161.61. In November, 1895, he again turned "bear" selling "short" in that single month 500 shares of Reading Railway Company, 200 shares of American Tobacco Company, 100 shares of American Sugar Refining Company, common, and 100 shares of Welsbach Light Company. In December, 1895, he also made short sales of Welsbach Light Company and American Sugar Refining Company, common. The account had been closed in 1893, but reopened thereafter. No stock was delivered to him after March 13, 1893, when the account was reopened. He testified that he did not intend to gamble. The account, however, including his enormous short sales, has all the earmarks of a gaming transaction, and I so find it. I disallow the claim.

Errors assigned were in dismissing exceptions to auditor's report.

MITCHELL, J. It has been settled by this court so often that it ought not to require reiteration that dealing in stocks even on margins is not gambling. Stocks are as legitimate subjects of speculative buying and selling as flour or dry goods or pig iron. A man may buy any commodity, stock included, to sell on an expected rise, or sell "short" to acquire and deliver on an expected fall, and it will not be gambling. Margin is nothing but security, and a man may buy on credit with security or without, or on borrowed money, and the money may be borrowed from his broker as well as from a third person. The test is, did he intend to buy, or only to settle on differences? If he had bought and paid for his stock, held it for a year and then sold, no one would call it gambling and yet it is just as little so, if he had it but an hour and sold before he had in fact paid for it. And so with selling. Every merchant who sells you something not yet in his stock but which he undertakes to get for you, is selling "short," but he is not gambling, because, though delivery is to be in the future, the sale is present and actual. The true line of distinction was laid down in *Peters* v. *Grim*, 149 Pa. 163, and has not been departed from or varied, "A purchase of stock for speculation, even when done merely on margin, is not necessarily a gambling transaction. If one buys stock from A and borrows the money from B to pay for it, there is no element of gambling in the operation, though he pledges the stock with B as security for the money. So, if instead of borrowing the money from B, a third person, he borrows it from A, or, in the language of brokers, procures A to 'carry' the stock for him, with or without margin, the transaction is not necessarily different in char-

acter. But in this latter case, there being no transfer or delivery of the stock, the doubt arises whether the parties intended there should ever be a purchase or delivery at all. Here is the dividing line. If there was not under any circumstances to be delivery, as part of and completing a purchase, then the transaction was a mere wager on the rise and fall of prices, but if there was in good faith a purchase, then the delivery might be postponed, or made to depend on a future condition, and the stock carried on margin or otherwise in the meanwhile, without affecting the legality of the operation." This has been uniformly followed. *Hopkins* v. *O'Kane*, 169 Pa. 478; *Wagner* v. *Hildebrand*, 187 Pa. 136. And the rule goes so far that an agreement for an actual sale and purchase will make the transaction valid although it originated in an intention merely to wager. *Anthony & Co.* v. *Unangst*, 174 Pa. 10.

Turning now to the facts of the present case, it is clear that the law was not correctly applied by the auditor and the court below. The brokers made an assignment on December 21, 1895, on which day they held certain stock for appellant, which they had bought on his order, and he had certain other stock which they had sold on his order, but which he had not yet delivered to them. He desired to close the account, complete the mutual deliveries, and receive the balance which the transactions left in his favor. He was entitled to do so, even if the transactions were wagering, the agreement of the parties to make the sales actual would, under *Anthony & Co.* v. *Unangst*, 174 Pa. 10, *supra*, have made them valid. It is true, the settlement was not actually made until January 10, but it was made as of December 20, the day before the assignment, and the auditor reports that there had been no change of values meanwhile. The time of striking a balance on the books and delivering the stock was not important. Delivery is not in itself a material fact. Its only value is as evidence of the intent to make a bona fide sale. If such is the intent, the delivery may be present or future without affecting validity.

But there was no sufficient evidence that the transactions were illegal at any time. The auditor reports that "the stocks ordered to be bought or sold by the customers of L. H. Taylor & Co. were, as shown by their books, actually bought and sold, and as this evidence is uncontradicted I must and do so find. Thus, so far as L. H. Taylor & Co. were concerned, the transactions were not fictitious, but were actual purchases and sales of stocks." This finding should have been

a warning to caution in taking a different view of the appellant's position in the transactions. It is true, the purchase or sale may be actual on part of the broker and merely a wager on part of the customer (see *Champlin* v. *Smith*, 164 Pa. 481), but there should be at least fairly persuasive evidence of the difference. There is none here. The transactions covered by the account began with a small cash balance to appellant's credit, followed by an order to buy 200 shares of Wabash common, which were bought by the brokers, paid for by appellant and delivered to him. The close, two years and half later, showed, as already said, a large number of shares in the hands of the brokers, bought for appellant and of which he demanded delivery, and other shares sold for him, and which he had in his possession ready to deliver. As to the intermediate transactions, appellant testified, "It was always the intention to buy the stocks out and out and pay for them, and I had money to do it with." In the face of these facts and this uncontradicted testimony, the auditor found that "the account, including his enormous short sales, has all the earmarks of a gaming transaction and I so find it." This was a mere inference, unwarranted by the account itself, and wholly opposed to all the evidence in the case.

Judgment, so far as it relates to appellant's claim, reversed and claim directed to be allowed.

QUESTIONS

1. D contracts to sell P 100 shares of stock at $90 a share, to be delivered ninety days from date. At the time the contract was made, D owned no stock. When the day for performance came, D defaults. P sues D for damages. He proves that on the day set for performance the stock was selling for $100 a share. May P recover? What is the measure of his damages?
2. In the foregoing case when the day set for performance arrives, D promises to pay P $1,000 in consideration of P's promise to release him from liability for damages on the original contract. This is an action by P to recover the $1,000. What defense can D possibly rely upon? What decision?
3. In case No. 1, it is agreed by the parties that on the day of performance, neither will call for performance and that the contract shall be deemed to have been performed by a settlement of differences on that day. P sues D for $1,000. What decision?
4. P contracts to sell wheat to D in May at $1.50 a bushel. When May arrives, wheat is $1.25 a bushel. P tenders D a warehouse receipt entitling D to the amount of wheat called for by the contract. This D

refuses to receive. P sues D for damages. D contends that the contract is illegal, because at the time he entered into it, he never intended to receive a delivery of wheat. What decision?

5. P and D enter into a contract for the sale of wheat in the future. At the time of the transaction, P intends to make a delivery of wheat, but D does not intend to receive it. What decision in an action by P against D for breach of the contract? What decision in an action by D against P on the contract?
6. P and D enter into a contract for the sale and purchase of future wheat. Neither intends that any wheat shall be delivered in performance of the contract, but it is provided that a delivery may be demanded by either party. P sues D for breach of the contract. What decision?
7. P is a miller, manufacturing flour for the wholesale trade. In September, he buys 10,000 bushels of wheat at $1.50 a bushel which he intends to make into flour and put on the market the following year. At the same time, he sells 10,000 bushels of May wheat, to D at $1.50 a bushel. A the time he makes the second contract, he does not contemplate an actual delivery of wheat to D. In the following May, wheat is worth $1.40 a bushel. What are the rights of D on this contract?
8. The court in the principal case says that *delivery* is the test of the validity of speculative contracts Do you think that delivery is a proper test of the validity of such contracts? If not, what better test can you suggest?

3. Contracts of Insurance

a) In General

HICKS *v.* BRITISH AMERICA ASSURANCE COMPANY
162 New York Reports 284 (1900)

Appeal from a judgment of the Appellate Division of the Supreme Court in the fourth judicial department, entered February 8, 1897, affirming a judgment in favor of plaintiff entered upon a verdict, and an order denying a motion for a new trial.

The action was brought to recover on an alleged oral contract to insure a certain building in the village of Penn Yan, entered into between George C. Hicks, the plaintiff's assignor, and Melmoth Hobart, the agent of the defendant.

PARKER, C. J. We are agreed that the verdict of the jury establishes that on the thirtieth day of December, 1893, defendant's agent Hobart had a conversation with Colonel Hicks, the plaintiff's assignor, the legal effect of which was to create a contract of present insurance in the sum of $2,500 upon property of Colonel Hicks,

which was consumed by fire two days later. The agreement that the contract was one of present insurance accords with the allegations of the complaint, the theory of counsel as shown by their method of trial and the charge of the court. That position cannot be attacked from any source, for either that which was said operated to create a contract of present insurance, or else no contract was ever made binding upon the defendant. The evidence tended to show a contract to insure, and nothing else. It is not pretended that a contract of any kind between these parties was made after the conversation of December 30. The jury have found that the defendant's agent said to Hicks, after a general discussion on the subject of insuring the property, "you are insured from noon on the thirtieth day of December, 1893, to noon of December 30, 1894." The legal effect of this answer to the application for insurance made by Colonel Hicks was to create a complete, binding agreement for insurance for the period named, upon which he was entitled to recover for the damages sustained by the fire had he made performance on his part. (*Ruggles* v. *American Central Insurance Co.*, 114 N.Y. 415.) This contract of insurance, although verbal, embraced within it the provisions of the standard policy of fire insurance, which the legislature in its wisdom formulated for the protection of both insured and insurer. It is usual for the company to issue a policy of insurance evidencing the contract between the parties but the policy accomplishes nothing more than that, for when the contract is entered into between the agent and the owner, whether the binder be verbal or in writing, it includes within it the standard form of policy and the contract is a completed one.

Plainly, therefore, it is not true that the plaintiff suffered damage in the amount of the contract of insurance by reason of the failure of the defendant to deliver a policy reciting the terms of the contract entered into, and hence the judgment cannot be affirmed on the ground that the plaintiff sustained damages in the sum of $2,500, because the defendant omitted to deliver a policy. Nor do I think that sound public policy would sanction the creation of such a precedent even if a legal principle could be found upon which to rest it.

The legislature of the state of New York has prescribed a standard form of policy for the protection of both insurer and insured. It contains provisions specially protecting the insured from harsh methods by insurance companies. On the other hand, it provides that which experience has shown to be necessary in order to protect

insurance companies from being victimized through fraud, and among the conditions which the legislature in its wisdom has caused to be incorporated into the standard policy is one making it necessary that the insurer shall have immediate notice of the facts and circumstances of the fire; another that within sixty days the owner shall present proofs of loss, duly verified, in which shall be stated the circumstances of the fire and the value of the property destroyed and various other things which it is deemed important that insurance companies should know before being called upon to adjust a loss; still another provides that no local agent shall have the power to waive any of these written conditions, except by a writing. It is unnecessary to present the reasons which induced the legislature to require these conditions precedent to a recovery upon a policy of insurance; it is sufficient for our purpose that the legislature declared that it should be so, and we should see to it that the general trend of our decisions is toward the enforcement of the legislature's command instead of its nullification. This plaintiff had the right, as it is conceded on all hands, to recover on the contract of insurance which her assignor made with the defendant's agent, whether a policy was subsequently delivered to him or not; but as the standard policy was necessarily a part of the contract, he should be required to comply with the conditions of that policy and give notice of the facts and circumstances of the fire and present proofs of loss duly verified. The view taken by some of my brethren, however, is that it was unnecessary to give notice of the fire and present proofs of loss within sixty days, or at any other time, because, it is said, such an action need not be treated as on a contract of insurance, but on a contract to give a policy, which has not been carried out, and, therefore, prior to beginning suit, which may be done at any time within six years instead of one year, as provided in the standard policy, the insured has nothing whatever to do when he sustains a loss by fire but lie until, as in this case, several months have passed, or, in some other case, until years have gone by, without giving the company notice of the fire or any proofs of loss whatever; he may bring suit claiming that two days, or less or more, before the fire, the defendant's local agent, without receiving any premium, agreed to, but did not, issue a policy, for which defendant is liable to plaintiff in the amount of the sum for which it was agreed that the policy should issue. If such a procedure should be sanctioned by this court, then might an insurance company be mulcted in damages without having had an opportunity to investigate

promptly the origin of the fire and the value of the thing destroyed, and thus would the door be opened wide for perpetration of fraud.

It follows, if the views expressed be sound, that the action is upon a contract of insurance and not one for damages resulting from a failure to deliver a policy, and, hence, that proofs of loss were necessary in the absence of a waiver thereof by the defendant, of which there is no proof, and the failure to so charge was error, calling for a reversal of the judgment.

The judgment should be reversed.

QUESTIONS

1. What was the issue under consideration in the principal case? How was the issue decided? What rule of law can be deduced from the decision?
2. The statute of frauds provides that no action can be brought to charge a party on a contract to answer for the debt, default, or miscarriage of another, unless the contract is in writing. Does this provision affect the validity of contracts of insurance?
3. The statute provides that no action can be brought on a contract which is not to be performed within the space of two years from the making thereof, unless the contract is in writing. Does this provision affect a contract by which an insurance company agrees to insure P's house against fire for a period of five years?
4. Does a contract of insurance arise out of offer and acceptance just as any ordinary contract does?
5. When does a contract of insurance become binding? Is delivery of the policy necessary to the validity of the contract?
6. Is a consideration necessary to the validity of a contract of insurance? What is the usual consideration for the insurer's promise to insure?
7. The D Insurance Company insures the life of P. P pays the first premium upon the delivery of the policy. Before he pays his next premium, he is notified by the company that his insurance has been discontinued. What are the rights of P under the circumstances.
8. In the foregoing case, P pays the first premium, but refuses to pay any premiums thereafter. (*a*) The company brings an action against him to recover the next annual premium. What decision? (*b*) The company brings an action to recover damages for P's failure to pay premiums. What decision? (*c*) If the company cannot recover in either of the two foregoing actions, what is its recourse in case the insured refuses or fails to pay his premiums when due?
9. The D Company insures P's house for a period of five years, P agrees to pay annually a certain premium. He pays the first premium but refuses to pay any thereafter. (*a*) The company sues for the premiums

as they fall due. What decision? (*b*) The company sues P for damages for breach of his contract. What decision?

10. It is said that underlying all contracts of insurance is the theory of indemnity. What is meant by this? To what extent can this theory be worked out in fire insurance? To what extent can it be worked out in life insurance? How is the theory of indemnity worked out in insurance contracts generally?

b) The Insurable Interest

RUSE *v.* THE MUTUAL BENEFIT LIFE INSURANCE COMPANY

23 New York Reports 516 (1861)

SELDEN, J. Our inquiry, therefore, is whether at common law, independent of any statute, it is essential to the validity of a policy, obtained by one person for his own benefit upon the life of another that the party obtaining the policy should have an interest in the life insured.

A policy, obtained by a party who has no interest in the subject of insurance, is a mere wager policy. Wagers in general, that is, innocent wagers, are, at common law, valid; but wagers involving any immorality or crime, or in conflict with any principle of public policy, are void. To which of these classes, then, does a wagering policy of insurance belong?

Aside from authority, this question would seem to me of easy solution. Such policies, if valid, not only afford facilities for a demoralizing system of gaming, but furnish strong temptations to the party interested to bring about, if possible, the event insured against. In respect to insurance against fire, the obvious temptation presented by a wagering policy to the commission of the crime of arson has generally led the courts to hold such policies void, even at common law. It was so held in England, at an early day, by Lord Chancellor King, in *Lynch* v. *Dalzell* (4 Bro. P. C., 431), and by Lord Hardwicke, in *Saddlers' Company* v. *Babcock* (2 Atk., 557); and the courts in this country have generally acquiesced in and approved of the doctrine. In this state, such policies would fall under the condemnation of our statute avoiding all wagers and gambling contracts of every sort; but they would, no doubt, also be held void, independently of that statute, at common law.

In *Howard* v. *The Albany Insurance Company* (3 Denio, 301), BRONSON, Ch. J. asserted the necessity of an interest in the assured

in all such cases, referring, in support of the doctrine, not to the statute but to the decisions of the Lord Chancellors King and Hardwicke (*supra*).

In regard, however, to marine insurances, a different rule seems to have prevailed in England; and the cases of *Clendining* v. *Church* (3 Caines, 141), *Juhel* v. *Church* (2 John. Cas. 333), and *Buchanan* v. *Ocean Insurance Company* (6 Cow. 318), are supposed to have established the same rule in this state. No reason, that I am aware of, has ever been given for this difference between fire and marine policies. The latter, when of a wagering character, are vicious and evil in their tendencies as well as the former, and have been generally considered as noxious and dangerous, whenever the question has arisen. They should, therefore, as it would seem, for the reasons applied to policies against fire, have been held void, as contrary to public policy.

The distinction between these two classes of policies is, in my view, a mere matter of accident, and grew out of the peculiar manner in which the question was presented in respect to marine policies. The case of *Depaba* v. *Ludlow* (Comyn, 361) shows how the doctrine, that wagering policies upon ships are valid, originated. The defendant there had insured the plaintiff, "interest or no interest." On the trial it was objected that the plaintiff could not recover, unless he had a property in the ship; but the court said that the insurance was good, and that the import of the clause, "interest or no interest," was, that the plaintiff had no occasion to prove his interest. Had the question been directly presented in this case, whether a mere wagering policy was valid, the decision would, I think, have been different. The case itself shows the court to have supposed that the plaintiff actually had an interest; and it is apparent, from the authorities that it had always been previously held, in suits upon policies not containing the words: "interest or no interest" or other equivalent words, that the plaintiff must aver and prove that he had an interest. This is distinctly asserted by Lord Hardwicke, in the case of *Sadler's Company* v. *Babcock* (*supra*); and in the case of *Crauford* v. *Hunter* (8 Term, 14), the counsel, on looking into the precedents at the request of the court, found that it had been the uniform practice, in suits upon marine policies, to insert an averment of interest. To me, therefore, it seems clear, that the decision in *Depaba* v. *Ludlow* was made because the court failed to distinguish between a waiver of proof at the trial, which the defendant was, of course, at liberty to make, and

a waiver in the policy itself, by which it was converted into a mere wager.

In consequence of this case, and others which followed it, Parliament was forced to interfere, as it did, by the act of 19 George II (chap. 37), reciting the mischiefs which had arisen from the making of marine insurances, "interest or no interest," and prohibiting them thereafter; and when the question subsequently arose in *Crauford* v. *Hunter* (*supra*) as to the validity at common law of a mere wagering policy upon a ship, it was held to be valid, solely upon the authority of the recitals in this act. It was in this indirect way that the doctrine in question, as to marine policies, first crept into the law. It was important to show this, because the effect of what I consider as the inadvertence of the court in *Depaba* v. *Ludlow* was not confined to policies upon ships. It must have been, I think, in consequence of the doctrine initiated by that case, that it came to be understood in England that, in insurance upon lives, it was not necessary at common law that the party to be benefited by the policy should have any interest in the life insured. There may not have been any direct decision to that effect; yet, that such was the prevalent impression, is to be inferred from the enactment of the statute of 14 George III (chap. 48), prohibiting insurance upon lives where the person insuring had no interest in the life. Angell, in speaking of this statute, says: "At common law it seemed to have been thought unnecessary that, at the time of effecting the policy, the assured should have had any interest which might be prejudiced by the happening of the event insured against." (Angell on *Life and Fire Ins.*, sec. 297.) In New Jersey they have no such statute; and the question now to be decided, therefore, is, whether the impression which seems to have prevailed in England prior to the statute of 14 George III was well founded.

That impression does not appear to be supported by any adjudged case. Life insurance seems not to have been practiced to a great extent in England until a comparatively modern date, and the probability is, that as soon as such insurance became frequent, the evils of gambling in them was so apparent that Parliament interposed, upon the assumption that the same rule would be applied to them as to insurances upon ships. I cannot regard that act as affording any very strong evidence, that, at common law, wagering policies upon lives were valid. It seems to me, that, were the naked question presented, whether such a policy comes within the admitted exception to the validity of wagers in general, that is, whether it is repugnant

to a sound public policy, no court, not hampered by some unfortunate or mistaken precedent, would hesitate for a moment in holding the affirmative.

In Massachusetts, in Vermont, in Pennsylvania, and I believe other states, it has been so held in regard to wager policies in general. But policies without interest, upon lives, are more pernicious and dangerous than any other class of wager policies; because temptations to tamper with life are more mischievous than incitements to mere pecuniary frauds.

Chancellor Kent was evidently embarassed by the position of this question in England. He commences his remarks on the subject by saying that "the party insuring must have an interest in the life insured," and then immediately refers to the English statute, of 14 George III, chapter 48, but says not a word upon the question whether at common law an interest was necessary. He, however, concludes by saying that "the necessity of an interest in the life insured, in order to support the policy, prevails generally in this country, because wager contracts are almost universally held to be unlawful, either in consequence of some statute provision, or upon principles of the common law." (3 Kent. Com., 368.)

This obscure manner of treating the subject is plainly to be attributed to the reluctance of the learned author to admit (notwithstanding the impression that appears to have obtained in England) that gambling in life insurance could be tolerated at common law. That impression has been here traced, as I think, with justice to the very questionable doctrine of the English courts in regard to marine policies. It has never, that I am aware of, been recognized and adopted by any American court, and is so obviously repugnant to the plainest principles of public policy that it is somewhat surprising that it should ever have existed. My conclusion, therefore is, that the statute of 14 George III, avoiding wager policies upon lives was simply declaratory of the common law, and that all such policies would have been void, independently of that act.

It is said that the defendants, by issuing the policy upon the representation of the plaintiff that he had an interest, have admitted his interest, and that the production of the policy is at least prima facie evidence of such interest. This position cannot be sustained. All the older authorities show, that even in actions upon marine policies, not containing the clause "interest or no interest," it was necessary to aver, and of course to prove, the interest of the plaintiff.

It is an indispensable part of the plaintiff's case, to be made out affirmatively at the trial. Upon this ground, therefore, as well as that before considered, the judgment of the Supreme Court for the plaintiff must be reversed; and there must be a new trial, with costs to abide the event.

QUESTIONS

1. What is the essence of a gambling or wagering contract? Were wagering contracts enforcible at common law? What objections may be urged against their enforcibility?
2. In case the insured has no interest in the subject-matter of the insurance contract, is there any question of shifting risks? If not, is there any justification at all for enforcing such contracts?
3. Even when a person has an interest in the subject-matter of an insurance contract, what is the justification for contracts by which one shifts his risks to another?
4. Do the various forms of risk-bearing eliminate the number or intensity of risks? If not, what defense can be made for permitting one person to shift his risks to another?
5. It is sometimes urged that one inevitable result of vicarious risk-bearing is a tendency toward lower standards of care over life and property. Is this true? If so, are there any safeguards against this tendency?
6. Assuming that risk-bearing devices place a premium on low standards of care, are there yet more serious risks which are avoided? If so, what are they?
7. P applies for insurance on the house of X and informs the company that he has no interest in the building. The company, however, issues the policy to him. For six months, P pays premiums on the policy, when the house is accidentally destroyed by fire. P sues on the policy. The company contends that the policy is void because P had no insurable interest in the property. P replies that D is estopped to deny his lack of insurable interest. What decision?

FOLEY *v.* THE MANUFACTURERS' FIRE INSURANCE COMPANY

152 New York Reports 131 (1897)

Appeal from a judgment of the General Term of the Supreme Court in the fourth judicial department, entered November 30, 1894, which affirmed a judgment in favor of plaintiffs entered upon a verdict.

This action was brought by plaintiffs upon a policy of insurance to recover damages alleged to have been caused by fire to three dwelling houses in process of construction for them.

ANDREWS, C. J. The sole question in this case is whether the plaintiffs had an insurable interest equal to the full value of the incomplete buildings in course of construction on their lot when the fire occurred. It is the contention on the part of the defendant that, as the houses were being constructed under a contract by which the contractors were to furnish the materials and build the houses (above the foundations) and to complete them by a time specified, which had not expired at the time of the fire, for a specified sum to be paid within ten days after their completion, the plaintiffs had no interest to protect in the structures while in their incomplete state, since their destruction by fire would be the loss of the contractors and not of the owners, whose obligation to build and complete the houses, as the condition of payment, would continue after as before the fire. It may be admitted that the contractors would remain bound by the contract, notwithstanding the destruction of the buildings by fire, and the owners would not be bound to pay for the work done or materials supplied up to the time of the fire. (*Tompkins* v. *Dudley*, 25 N.Y. 272.) The contention of the defendant rests upon a misconception of the insurer's contract and as to the insurable interest of the plaintiffs in the structures. The defendant, by its contract, undertook to insure the plaintiffs against loss by fire, not exceeding the sum specified to the "described property," the loss or damage to be ascertained "according to the actual cash value" of the property at the time of the fire. The parties by this contract made the value of the property insured, within the limit, the measure of the insurer's liability. It is an undoubted principle of fire insurance that there must be an insurable interest or an insurable interest which he represents in the subject of insurance, existing at the time of the happening of the event insured against to enable him to maintain an action on a fire policy. This flows from the nature of the contract of fire insurance which is a contract of indemnity; and where there is no interest there is no room for indemnity. The plaintiffs had an interest in the subject of insurance both at the inception of the contract and at the time of the fire. They owned the land upon which the structures were being erected. They themselves had constructed the foundations of the buildings, and in describing the property insured, the foundations were specifically named. They were in possession of the premises, and the ownership of the fee of the land on which the contractors were erecting the buildings carried with it the ownership of the structures as they progressed, which, according to the general rule of law, became part of

the realty by annexation. It is not claimed, nor could it upon the evidence be claimed, that there was any intention either on the part of the owners or the contractors to sever the ownership of the structure from the ownership of the land while the work was in progress or that the contractors should retain the title to the materials put into the buildings until their completion. The defendant is compelled to admit that the loss sued for is within the exact terms of the policy. It is conceded that the recovery does not exceed the property loss occasioned by the fire, and if counsel can be deemed to have denied that the legal ownership of the structures was in the owners of the land at the time of the fire, the denial is very indistinct and certainly is not justified by the facts or the law. The defense comes to this: That as the plaintiffs, by their contract with third persons, have imposed upon them the risk and expense of furnishing complete structures, and have assumed no liability until the structures are completed, they had no insurable interest and have sustained no loss. But the contract relations between the plaintiffs and the contractors is a matter in which the defendant has no concern. When the policy was issued it could not be known whether the contractors would perform their contract. If they abandoned it the owners would derive such advantage as would accrue from the partial construction of the buildings prior to such abandonment. It is possible that if the defendant is compelled to pay the policy the plaintiffs may, if they insist upon their rights against the contractors, get double compensation, unless they should be adjudged to hold the fund recovered for the contractors. But, however this may be, the owners had an insurable interest to the whole value of the buildings on their land, and the defendant neither can compel the plaintiffs to put the loss on the contractors, nor can they resort to the terms of the building contract to diminish the liability from an actual loss within the terms of the policy.

The fact that improvements on land may have cost the owner nothing, or that if destroyed by fire he may compel another person to replace them without expense to him, or that he may recoup his loss by resort to a contract liability of a third person, in no way affects the liability of an insurer, in the absence of any exemption in the policy. (See *Clover* v. *Greenwich Insurance Co.*, 101 N.Y. 277; *Kernochan* v. *N.Y. Bowery F. Insurance Co.*, 17 *idem* 428; *Riggs* v. *C.M. Insurance Co.*, 125 *idem* 7; *International Trust Co.* v. *Boardman*, 149 Mass. 158.)

The judgment should be affirmed.

QUESTIONS

1. The court permitted the plaintiffs, in the principal case, to recover from the insurer. Suppose now that the plaintiffs sue the contractors for their failure to complete the building. What decision?
2. Suppose that the contractors had effected insurance on the incompleted building, would they have been permitted to recover from the insurance company?
3. T is trustee of a house and lot for C. (*a*) What insurable interest, if any, does T have in the building? (*b*) What insurable interest, if any, does C have in the building?
4. P executes a mortgage on a house and lot to M to secure a debt. (*a*) Does P have an insurable interest in the building? (*b*) Does M have an insurable interest in the building?
5. X conveys a house and lot to P for life, remainder to M in fee. (*a*) Does P have an insurable interest in the house? (*b*) Does M have an insurable interest in it?
6. X leases land to P for a period of ninety years. P erects a building on the land, with the understanding that the building is to become the property of X, on the termination of the lease. (*a*) Does X have an insurable interest in the building? (*b*) Does P have an insurable interest in the building?
7. X leases a house and lot to P for a period of three years. P insures the building. In an action on the policy, the insurer contends that P cannot recover because he has no insurable interest. What decision?
8. P is contemplating the purchase of a certain house and lot from X. In anticipation of this, he effects insurance on the property. The house burns after the purchase is made. P sues the insurer on the policy. What decision?
9. In the foregoing case, X had insurance on the building, which he effected prior to the transaction in question. X brings an action against the insurer for the loss. What decision?
10. P, a merchant, takes out a policy of insurance on his stock in trade for the year 1922. In the latter part of the year, the building and all its contents were burned. P sues the insurer for the loss. The insurer contends that P cannot recover because the goods burned were not in stock when the contract was made. What decision?

WAINER *v.* MILFORD MUTUAL FIRE INSURANCE COMPANY

153 Massachusetts Reports 335 (1891)

Contract upon a policy of insurance, in the form prescribed by the Pub. Sts., Sts. c. 119, sec. 139 (St. 1887, c. 214, sec. 60), against

loss by fire. At the trial in the Superior Court before MASON, C. J., the plaintiff submitted the case upon the report of an auditor, and the judge ordered a verdict for the defendant, and reported the case for the determination of this court. If upon the facts a finding would be warranted for the plaintiff, the verdict was to be set aside and a verdict entered for the plaintiff for a sum agreed; otherwise, the verdict was to stand. The facts appear in the opinion.

W. ALLEN, J. There are two grounds presented by the auditor's report on which the defendant contends that the policy was void; first, that the building had been vacant for more than thirty days before the loss, and during the continuance of the policy; and secondly, that the plaintiff was not the sole owner of the property.

We think that the plaintiff had an insurable interest in the entire property to its full value, and that his answer that he owned it was a fair representation of the fact. The plaintiff and his brother had been tenants in common in fee of the property. Five years before the insurance the plaintiff bought of his brother his undivided interest by an oral contract, and paid the full consideration, the brother promising to make and deliver a deed. The plaintiff went into exclusive possession of the whole, and has continued in such possession since, claiming title. His brother never disputed his title, or refused to give a deed, and a week after the fire made a deed in pursuance of his promise. It is said that the plaintiff had no insurable interest in the undivided half, because he could not enforce the oral contract, and had no legal or equitable title to the premises.

An insurable interest in property need not necessarily be a right in it which can be legally enforced. We are by no means prepared to hold that a jury could not, upon the facts found by the auditor, have found such part performance of the contract by the plaintiff's brother that it could have been specifically enforced against him. But we do not think that it is necessary to show an insurable interest which may be called ownership. Insurance against loss by fire is a personal contract of indemnity. If a person has such an interest in property that he will suffer pecuniary loss by its destruction, he has an insurable interest. A valid contract for its purchase is such an interest. It has been said that a contract for purchase which is made incapable of enforcement by the statute of frauds is not itself such an interest, because the purchaser cannot be compelled to pay the price, and so would lose nothing by the destruction of the property. But it has been held that such a contract is a valid subsisting contract which

may be carried out between the parties, and constitutes an insurable interest in the property. *Amsinck* v. *American Insurance Co.*, 129 Mass. 185.

There was not only that interest in the case at bar, but the distinct and more satisfactory interest, that the plaintiff had fully executed the contract on his part, and had paid the entire purchase money, and would suffer the same loss by the destruction of the buildings as if he had the legal title. The only answer to the proposition that this pecuniary interest in the house was the same as that of legal owner is, that he could not hold it against his brother. But this does not affect the fact that the destruction of the house would destroy what he held as the full value of the purchase money he had paid, and it amounts to nothing more than saying that his title was defective. He had been in possession for five years under claim of title, paying taxes, and receiving the rents and profits. If he held as disseisor, no question would be made that he had an insurable interest which could be properly described as ownership. His interest was more real and valuable than if he held merely as disseisor; he added to the direct pecuniary interest, and to possession under claim of title, the fact that the contract had been in part executed by the other party by submitting to the exclusive occupancy of the plaintiff, and the strong probability that it would be fully carried out on request. To this is to be added the fact that, as in *Amsinck* v. *American Insurance Co.*, *supra*, it was in fact carried out before the commencement of the action. We think that the plaintiff, whether he could or could not have compelled specific performance of the contract, had an insurable interest in the property to its full value, and properly described himself as owner, and is entitled to recover the full amount. *Strong* v. *Manufacturers' Insurance Co.*, 10 Pick. 40; *Curry* v. *Commonwealth Insurance Co.*, 10 Pick. 535; *Fletcher* v. *Commonwealth Insurance Co.*, 18 Pick. 419; *Putnam* v. *Mercantile Insurance Co.*, 5 Met. 386; *Converse* v. *Citizens Insurance Co.*, 10 Cush. 37; *Eastern Railroad* v. *Relief Insurance Co.*, 98 Mass. 420; *Williams* v. *Roger Williams Insurance Co.*, 107 Mass. 377.

According to the terms of the report, there must be judgment for the plaintiff for seven hundred dollars, and interest from the date of the writ.

Judgment for the plaintiff.

QUESTIONS

1. What was the insurable interest of the plaintiff in the principal case? Would his rights in the property have been enforced in law or in equity?
2. X, in writing, contracts to convey a house and lot to P. What are P's rights against X on the contract? Does P have an insurable interest in the property? Does X have an insurable interest in it?
3. X orally agrees to convey a house and lot to P. What are P's rights on the promise? Does he have an insurable interest in the property?
4. X orally agrees to sell a house and lot to P. P pays the full purchase price and goes into possession of the property. He effects insurance on the house. What decision in an action on the policy for a loss by fire?
5. P goes into possession of property which he does not own but which he holds and claims as owner. H erects a house on the land and takes out insurance on it. What decision in an action by P on the policy?
6. X by fraud induces P to convey to him a house and lot. Does P have an insurable interest in the house after the transaction? Does X have an insurable interest in the property?
7. P executes a mortgage on Blackacre to M to secure a debt of $5,000 which he owes to M. M assigns his claim to A. P sells the mortgaged premises to B, who agrees to pay the debt. Which of the foregoing parties, if any, has any insurable interest in a house which stands on Blackacre?

CREED *v.* THE SUN FIRE OFFICE OF LONDON

101 Alabama Reports 522 (1893)

COLEMAN, J. The next proposition involves a question new in this state. Has a creditor an insurable interest in a building, the property of the estate of his deceased debtor, which may be subjected to his debt, the personal property being insufficient to pay the debts of the estate? After much deliberation our conclusion is that he has an interest which may be insured. We concede and affirm that a simple contract creditor, without a lien, either statutory or contract, without a *jus in re* or *jus ad rem*, owning a mere personal claim against his debtor, has not an interest in the property of his debtor. Such contracts are void as being against public policy. We do not think the principle applies after the death of the debtor, as to property liable for the debt and which, if destroyed, will result in the loss of the debt. The real estate as well as the personal property of a deceased debtor is liable for his debts but the real estate cannot be subjected to the payment of his debts until after the personalty has been exhausted. After the death of the debtor the debt is no longer

enforceable *in personam*. The proceedings to reach the property of the estate of the deceased debtor are *in rem*. The property of the debtor takes the place of the debtor and becomes, as it were, the debtor. Whoever knowingly receives the property of a deceased debtor and wrongfully converts it, is answerable to the creditor. 3 Brick. Dig. 464, sec. 148; Ib., 465, sec. 162.

The relation of creditor and debtor invests the creditor with an insurable interest in the life of his debtor to the extent of his debt. *Alexander* v. *Sanders*, 93 Ala. 345, 9 So. Rep. 388; 11 Amer. & Eng. Encyc. of Law, p. 319. It would seem upon like principles that when the property becomes directly subject to proceedings *in rem* for the satisfaction of the debt, the creditor should become invested with an insurable interest in the property. Certainly if a creditor cannot obtain satisfaction of his debt from the personal property of his deceased debtor, and has a legal right, which cannot be defeated, to enforce its collection, by proceedings *in rem* against a building belonging to the estate of the deceased debtor, and if it be true that the destruction of the building by fire would immediately and necessarily result in pecuniary loss, the loss being the direct consequence of the fire, the creditor has an interest in the protection of the building. He has no lien as in the case of a mortgagee, nor such lien as the statute may confer on an attaching or execution creditor, but his right to subject the specific property to his debt invests him with an interest but little less, if any, than that of the attaching or execution creditor or mortgagee. In the case of *Herkimer* v. *Rice*, 27 N.Y. 163, the question arose as to whether an administrator of an insolvent estate held an insurable interest in the real estate of the deceased debtor. The court (Denio, C. J. rendering the opinion) held that he did, and the conclusion was based in great part upon the proposition, that the creditors had such an interest, which the administrator could protect by insurance for them. We think whatever could be done by an administrator for the creditor in this respect, could be done directly by the creditor for himself. *Rohrbach* v. *The German Fire Insurance Co.*, 62 N.Y. 47. Other reasons might be given, but we are of the opinion these are sufficient to show that the creditor of a deceased debtor, whose estate is insufficient to pay the debts, has an insurable interest in the property of the estate, which by law may be subjected by proceedings *in rem* to the payment of the debts. The recovery cannot exceed the amount of the insurable interest.

QUESTIONS

1. After having recovered a judgment against D, his debtor, C effects insurance on a house belonging to D. The house, with the lot on which it stands, is the only property which D has. The house burns. The value of the lot is insufficient to satisfy the judgment. P sues the insurer for the loss. What decision?
2. P recovers a judgment against X. By virtue of the judgment a levy is made on X's house and lot. Thereupon, P effects insurance on the house. Before a sale under the levy is made the house burns. What decision in an action by P against the insurer on the contract?
3. In some states, it is provided by statute that the rendition of a judgment gives the judgment creditor a lien on the debtor's property located in the county in which the judgment is entered. Does a judgment creditor, in a state where such a statute exists, have an insurable interest in the property of his debtor?
4. D owes P $5,000. D is practically insolvent and owns nothing but a house and lot, reasonably worth $4,000. P effects insurance on the house to its full value. What are his rights on the policy in the event of the destruction of the house by fire?
5. P sells a consignment of goods to X on credit and remains in possession of them. (*a*) Has P an insurable interest in the goods? (*b*) Has X an insurable interest in them?
6. P sells a house and lot to X. X gave his notes for the purchase price. (*a*) Has P an insurable interest in the house? (*b*) Has X an insurable interest in it?

WARREN *v.* THE DAVENPORT FIRE INSURANCE CO.

31 Iowa Reports 464 (1871)

MILLER, J. The question raised by the demurrer is, whether the parties effecting the insurance in this case had an insurable interest in the property insured, at the time the risk was taken and at the time of loss by fire.

Policies of insurance founded upon mere hope and expectation and without some interest are said to be objectionable as a species of gaming, and so have been called wager policies. These policies were expressly prohibited in England by Statute of George II, chap. 37, and they have been adjudged illegal and void in this country upon the principles of that statute. Angell on *Fire & Life Insurance*, secs. 18, 55. It is not that wager policies are without consideration unequal between the parties that they are held void; but because they are contrary to public policy. Policies of fire insurance, without interest, are peculiarly and extremely hazardous by reason of the

temptation they hold out to the commission of arson by the party assured, which is necessarily attended with peril of the most deplorable kind to a whole neighborhood. In *King* v. *State Mutual Fire Insurance Co.*, 7 Cush. (Mass.) 10, Mr. Chief Justice SHAW says: "If an insurance contract were made on a subject in which the assured has no pecuniary interest—although in other respects he may be deeply concerned in it, and on that ground be willing to pay a fair premium—made with full knowledge of all the circumstances, by both parties, without coercion or fraud, we cannot perceive why it would not be valid as between the parties. But upon the strong objections, on grounds of public policy to all gaming contracts, and especially to contracts which would create a temptation to destroy life or property, such policies without interest are justly held void." Upon the ground of public policy, therefore, if the assured have no interest in the thing insured, the policy must be held void. This is well settled. On the other hand, it is equally well settled that not only the absolute owner, but anyone having a qualified interest in the property insured, or even any reasonable expectation of profit or advantage to be derived from it, may be the subject of insurance and especially if it be founded in some legal or equitable title. *Idem*, sec. 56. And the general doctrine that any interest in the subject-matter insured is sufficient to sustain an insurance upon real property is one which has been fully sustained. *Idem*, sec. 57, and notes. Several persons owning different interests in the same property may insure their several interests. And it is not material whether the interest assured be legal or equitable. Any interest which would be recognized by a court of law or equity is an insurable interest.

The interest of a *cestui que trust*, mortgagor, mortgagee, of a lender or borrower on bottomry, so far as regards the surplus value, or of a captor, or of one entitled to freight or commissions, is insurable. So where a lessor on ground rent has entered for the arrears, under a covenant that he may hold until the arrears are paid, etc., has an insurable interest. So also in case of one in possession of land by disseisin. Angell on *Fire and Life Insurance*, secs. 57, 58, 59; 2 Parsons on *Cont.*, sec. 2, of chap. 14, commencing on p. 438, and cases cited; 2 Greenlf. on *Ev.*, sec. 379.

The term interest, as used in application to the right to insure, does not necessarily imply property (*Hancock* v. *Fishing Insurance Co.*, 3 Summer's C.C. 132; Angell on *Life and Fire Insurance*, sec. 56), and as the contract of insurance is one of indemnity against

losses and disadvantages, an insurable interest may be proved in the assured, without the evidence of any legal or equitable title in the property. *Putnam* v. *Mercantile Insurance Co.*, 5 Metc. 386; *Lazarus* v. *The Commonwealth Insurance Co.*, 19 Pick. 81, 98. An "insurable interest" is *sui generis*, and peculiar in its texture and operation. It sometimes exists where there is not any present property, or *jus in re*, or *jus ad rem*. Yet such a connection must be established between the subject-matter insured, and the party in whose behalf the insurance has been effected, as may be sufficient for the purpose of deducing the existence of a loss to him from the occurrence of the injury to it. *Buck* v. *Chesapeake Insurance Co.*, 1 Pet. 163.

In the case under consideration, the assured were stockholders in the Dubuque Lumber Co., a corporation for pecuniary profit. The property destroyed belonged to the corporation. The insurance was upon the interest which the assured had in that property by virtue of the capital stock therein owned by them.

The object of the insurance was to indemnify the assured against loss to them in the event of a destruction of the property by fire. Could or would they sustain loss in such event? How would their interest be affected? It seems to us to be beyond controversy, that, in case of the destruction of the corporate property by fire, the stockholders sustain loss to a greater or less extent, dependent on the particular circumstances. Suppose the case of a grain elevator upon some one of our numerous railroad lines, built, owned, and managed by a joint stock corporation; that this is the only property of the corporation; that the entire capital stock is represented in and by this property; that, in consequence of the profitable nature of the business, large dividends are realized by the stockholders, and the stock is above par in the market. The destruction of this property by fire would at once result in the loss of dividends to the stockholders and a destruction of the value of the stock, or at least its reduction to a nominal value. The entire property, representing the whole capital of the corporation, being destroyed, it is difficult to perceive what would give any value to the stock. It is true that, primarily, the loss is that of the corporation and hence it may insure, but the corporation may refuse to insure and then the real and actual loss falls on the stockholders.

The appellee argues that shares of stock in a corporation are choses in action, and are not considered to be an interest in the real property of the company, and cites numerous authorities to sustain this position.

This may be admitted without denying the shareholders' "insurable interest" in the property of the corporation. A mortgage, also, is but a chose in action. The mortgagee acquires no right to the mortgaged property which can be attached, levied on under a general execution or that can be inherited. It is a mere security for a debt. *Eaton* v. *Whitney*, 3 Pick. 484; *Smith* v. *People's Bank*, 11 Shep. (Me.) 185; *Abbott* v. *Mutual Fire Insurance Co.*, 17 *idem* 414; *Middleton Savings Bank* v. *Dubuque*, 15 Iowa, 394; *Newman* v. *DeLorimer*, 19 *idem* 244; *Baldwin* v. *Thompson*, 15 *idem* 504; *Burton* v. *Hintrager*, 18 *idem* 348; Hilliard on *Mort.* 215.

And yet the cases are uniform to the effect that a mortgagee of real property has an insurable interest therein which he may insure on his own account, but that when he does so it is but an insurance of his debt. *Eaton* v. *Whitney*, *supra*. And in case of damage by fire to the premises before payment of the mortgage, his loss, if any, is that his security has been impaired or lost. His interest is but a chose in action in the nature of a security, which he may insure, so that in case of destruction of or damage to the property upon which his security rests, he will be indemnified for the loss he actually sustains. So, also, it seems to us, that the owner of stock in a corporation for pecuniary profit has a like interest in the corporate property. A mortgagee of real property has an insurable interest in the mortgaged premises, based upon the interest he has in the preservation of the same as security for a debt. He has a legal right to contract for indemnity against injury to the value of his security.

Upon precisely the same principle a stockholder may contract for indemnity against injury to the value of his stock, for he also has an interest in the preservation of the corporate property from destruction by fire; and in its destruction he sustains loss in so far as the value of his stock is depreciated in consequence thereof, or his dividends cut off.

The argument, that if this is allowed owners of stock worth not more than 10 per cent upon its nominal value may be insured at its par value, and in case of loss by fire such par value of the stock recovered from the insurer, seems to us to be unsound. Without entering into a discussion in detail of what would be the exact measure of recovery in such case, we simply answer that no more than the actual loss sustained is in any case recoverable. This rule is well established, and rests upon just principles. See Angell on *Fire and Life Insurance*, chap. 11, and cases cited in notes.

The question under consideration has not received direct judicial determination in any of the states, so far as we have been able to discover. The case of *Phillips* v. *Knox County Insurance Co.*, 20 Ohio, 174, is cited and claimed as an authority against the right of the stockholder to insure. The decision in that case, as a careful examination of the same fully shows, was made entirely upon a construction of the charter of the insurance company, which gave a lien on the insured property, including the land on which the buildings stand. By the charter a sale of the insured property rendered the policy void, and the ninth section declared, that if the insured have a less estate than an unincumbered title in fee simple to the buildings insured and the lands covered by the same, the policy shall be void, unless the true title of the insured and the incumbrances be expressed in the policy and in the application therefor. The plaintiff insured as owner of the property, which in fact belonged to a corporation of which he was a stockholder, and the court held that "where a building and the land on which it stands is the property of an incorporated company, the stockholders could not, under the provisions of of the defendant's charter, insure such property as their individual property in the defendant's company."

Under the charter of that company, a mortgagee even, insuring the property as his own, would likewise be defeated in a recovery. So the owner in fee simple could not recover if the property was incumbered and the incumbrance not set forth in the policy. And of course the same result must follow where a stockholder insures corporate property as his own individual property. The decision in that case goes no farther than this, and is no authority in support of the proposition, that a stockholder has no insurable interest in the property of the company, and hence, has no bearing upon the question before us.

The judgment of the district court is reversed.

QUESTIONS

1. What property was insured in this case? To whom did it belong? Did the plaintiff have legal or equitable title in the property or interest in it?
2. P, a mere intruder, erects a building on X's land and takes out insurance on it. The building burns and P sues the insurer for the loss. What decision?
3. P finds valuable personal property and advertises for its owner. He effects insurance on it while waiting for the owner to disclose himself. What are his rights under the policy in case of loss?

4. As a favor to X, P agrees to take possession of X's silverware while X is away from his home. P takes out insurance on the silverware against burglary. What are P's rights on the policy in case the property is stolen?
5. Would your answer be the same in the foregoing case if P were a hired bailee of the property? Would your answer be the same if the bailment had been for P's sole benefit?
6. P is a merchant to whom goods have been consigned for sale on commission. While the goods are in transit, P effects insurance on them. This is an action on the policy. The insurer contends that the policy is void because P had no insurable interest in the goods. What decision?
7. P is in possession of a house and lot belonging to X as a tenant at will. What insurable interest, if any, has P in the house?
8. X, in writing, gratuitously promises to convey a house and lot to P. P immediately effects insurance on the house. (*a*) Before a conveyance is made, the house burns. What are P's rights on the policy? (*b*) After the conveyance is made, the house burns. What are P's rights on the policy?
9. X makes his will in which he declares that all his property shall go to P. P immediately takes out insurance on a certain house which he expects to get. (*a*) Before X dies, the house burns. (*b*) After X dies, the house burns. What are the rights of P on the policy under each hypothesis?

CRONIN *v.* VERMONT LIFE INSURANCE COMPANY
20 Rhode Island Reports 570 (1898)

Assumpsit on a policy of insurance issued upon the life of the plaintiff's niece. Heard on demurrer to the declaration setting up lack of insurable interest.

STINESS, J. This action is brought to recover insurance on the life of the plaintiff's niece, and the main question raised by the defendant to the declaration is whether the plaintiff had an insurable interest in the life of her niece.

The English act of 1774, 14 Geo. III, chap. 48, sec. 1, prohibited insurance on the life of a person in which the beneficiary shall have no interest, or by way of gaming or wagering.

Although the statute has never been taken as a part of our law, its rule was generally followed in this country, as declaratory of the common law. But in defining the term "interest" the tendency of the decisions, both in England and in this country has been inclusive rather than exclusive.

There has even been some question whether insurance without interest should be held to be void on the ground of public policy;

but, in this state, we think it has been understood to be settled, since *Mowry* v. *Homes Insurance Co.*, 9 R.I. 346, that some insurable interest must exist. This, too, is the generally accepted rule.

In *Clark* v. *Allen*, 11 R.I. 439, it was held that a policy valid in its inception, could be transferred to a bona fide purchaser, even though he had no interest in the life, and some of the objections to such insurance, on the ground of public policy, were considered and shown to be fanciful and not applied to other branches of law. For example, the element of chance enters into annuities, and the temptation to shorten life in order to hasten the possession of a remainder-man, after a life estate in real property, is as strong as in the case of a beneficiary under a life policy. But these things have never been considered to be contrary to public policy.

Still, upon principle, a purely speculative contract on the life of another is as objectionable, on the grounds of public policy, as a like contract in regard to grain or stocks. In fact, it is more so, and such a contract may properly be held to be void.

But the case is quite different when one, by his own contract, or even in the name of another, or upon the ground of debt, affection, or mutual interest procures insurance for the benefit of another, which is really to stand in the place of a testamentary gift. And so kinship and debt have come to be recognized as sufficient grounds of interest. Bliss on *Life Insurance*, 2d ed., secs. 12, 13; 1 May on *Insurance*, 3d ed., sec. 102A.

Recent decisions have gone further, looking more to the situation of the parties than to these relations alone.

In *Lord* v. *Dall*, 12 Mass. 115, it was held that a sister had an insurable interest in the life of a brother, who stood to her in *loco parentis*. The court said: "In common understanding no one would hesitate to say that in the life of such a brother the sister had an interest." The later case of *Loomis* v. *Eagle Insurance Co.*, 6 Gray, 396, involved the question of the interest of a father in the life of a minor son, but SHAW, C. J., said that upon broader and larger grounds, independently of the fact that the son was a minor and that the assured had a pecuniary interest in his earnings, the court was of opinion that the father had an insurable interest. These broader grounds appeared further on to be "consideration of strong morals and the force of natural affection between near kindred, operating often more efficaciously than those of positive law."

In *Aetna Insurance Co.* v. *France*, 94 U.S. 561, a case between brother and a married sister, not dependent, BRADLEY, J. goes so far as to say: "Any person has a right to procure insurance on his own life and assign it to another, provided it be not done by way of cover for a wager policy; and where the relationship between the parties, as in this case, is such as to constitute a good and valid consideration in law for any gift or grant, the transaction is entirely free from such imputation. The direction of payment in the policy itself is equivalent to such an assignment."

In *Elkhart* v. *Houghton*, 103 Ind. 286, the insurable interest of a grandson in the life of a grandfather, with whom he lived, was upheld. It has also been sustained where there was no kinship, as in the case of a woman who was engaged to be married to a man; *Chisholm* v. *Nat. Capitol Insurance Co.*, 52 Mo. 213; and in the case of a widow and her son-in-law, who lived together; *Adams* v. *Reed*, 38 S.W. Rep. (Ky.) 420.

The principle of these, and other like cases, is that the interest does not depend upon any liability for support nor upon any pecuniary consideration, nor even upon kinship. It may be for the benefit of the old or the young, where the relation between the parties is such as to show a mutual interest and to rebut the presumption of a mere wager. The contract is complete and legal in itself, and when considerations of public policy do not prohibit its enforcement there is no reason why it should not be carried out.

The declaration in this case shows that the plaintiff's claim is not objectionable on the grounds of public policy. It shows that the relation of the plaintiff and her niece had been of such a character that each had reason to rely upon the other in case of need. Should the younger die first, the help and care which might have been expected from her, in the declining years of the aunt, could only be supplied by insurance upon her life. This is no more speculation than a husband's provision for his wife in the same way. It is natural and reasonable, and in accordance with modern business methods. In short, it is security for an insurable interest.

We therefore think that the contract set out in the declaration is valid, since it falls within the proper line of distinction between valid contracts, where there is mutual interest, and invalid contracts which are evidently mere speculation.

The demurrer to the declaration is overruled.

QUESTIONS

1. What test did the court announce in this case for determining whether one person has an insurable interest in the life of another person?
2. Does a person have an insurable interest in his own life? If so, what is it?
3. P insures the life of X, his cousin. What decision in an action on the policy after the death of X?
4. P effects insurance on the life of W, to whom he is under a contract to marry. W dies before they are married. P sues the insurer on the policy. What decision?
5. P takes out insurance on the life of his son, now twenty-one years of age and self-supporting. What decision in an action by P on the policy?
6. P, an infant, lives with X and is supported by her, but no blood-relation exists between them. Has P an insurable interest in the life of X? Has X an insurable interest in the life of P?
7. P takes out insurance on the life of X, a stranger to him. When X dies, P sues the insurer on the policy. What decision?
8. In the foregoing case, after the insurance policy had been issued and before the death of X, P had legally adopted X as a son. What decision in an action by P on the policy?
9. In general what is the amount of recovery on a fire insurance policy? What is the amount of recovery on a life insurance policy?

RITTLER *v.* SMITH

70 Maryland Reports 261 (1889)

MILLER, J. In June, 1886, Victor Smith was indebted to William H. Rittler in the sum of about $1,000, and Smith being insolvent, Rittler took out certificates of insurance on Smith's life, in four several mutual aid associations, aggregating on their face the sum of $6,500. These certificates were all in favor of Rittler and he paid all the premiums or assessments thereunder. Smith died in March, 1887, and Rittler collected from these insurances the sum of $2,124.82, which appears to have been all that could have been collected, according to the terms of the certificates, and the financial condition of the associations. Deducting from this sum the debt and interest due Rittler, the premiums he had paid, and the costs and expenses of effecting the insurances, there remained a balance of $474.53, as of the first of June, 1887. On the third of October following, letters of administration on Smith's estate were granted to an administratrix, who thereupon filed her bill claiming this balance as belonging to the estate of the decedent. In his answer Rittler denied this claim, and

insisted that the money belonged to him. The case was heard on bill and answer, and the court below decreed in favor of the complainant. From this decree Rittler has appealed.

The question as thus presented is an interesting one, is of first impression in this state, and has been very ably argued. On the part of the appellant it is contended that where a creditor with his own money and for his own account, effects and keeps up an insurance on the life of his debtor, the whole of the proceeds belong to him unless it appears that he has gone into it for the mere purpose of speculation, which in this case is expressly negatived by the answer, the averments of which must be taken as true, the case having been heard on bill and answer. On the other hand, counsel for the appellee contend, that where the creditor receives more than enough to reimburse him for his debt and outlay, with interest, he will, as to the balance be regarded as a trustee for the personal representative of the debtor; that the law says to the creditor in such a case, "you may protect yourself; you may by insuring your debtor's life secure your debt with all outlay and expenses; you may make yourself whole, but you shall not speculate on his death; you shall not have a greater direct pecuniary interest in his death than you may have in his life."

There have been numerous decisions upon this subject, some of which are conflicting. On many points, however, bearing upon the question, there is a general concurrence of judicial opinion and authority. For instance, it is generally held by the courts in this country that one who has no insurable interest in the life of another cannot insure that life. Such insurances are considered gambling contracts, and for that reason void at common law apart from any statute forbidding them.

In England they were held valid at common law, but were prohibited as introducing a "mischievous kind of gaming," by the first section of Statute 14 Geo. III, chap. 48. The effect of this section, as construed by the English courts, is to make the law of England, by act of Parliament, the same as it has been held to be by the courts in this country without such an act. In some American cases they have been denounced as void not simply because they tend to promote gambling, but because they are incentives to crime.

The force of this latter suggestion has been and may well be doubted. It means that one not related or connected by consanguinity or marriage, who may have a direct pecuniary interest in the speedy death of another, will thereby be tempted to murder him,

though he knows that hanging is the penalty for such a crime. This doctrine carried to its logical result has a far-reaching effect. It strikes down every legacy to a stranger which may become known to the legatee, as is frequently the case, before the death of the testator. It makes void every similar limitation in remainder after the death of a life tenant. Every like conveyance of property in consideration that the grantee shall support the grantor during his life, falls under the same condemnation. Yet we know of no case in which a court has declared such testamentary dispositions or conveyances to be void on this ground. Other instances in which the same result would follow from the application of this doctrine, could be readily suggested, but we need not pursue the subject further.

All the authorities also concur in holding that a creditor has an insurable interest in the life of his debtor. In England, it was at one time held that though the creditor had an insurable interest at the time the policy was issued, yet if his debt was paid in the lifetime of his debtor, and his interest had therefore ceased, he could not recover, because the contract of life insurance, like insurances of property, was one of indemnity. But this doctrine has long since been repudiated, and the settled rule in England now is, that a life insurance in no way resembles a contract of indemnity, but is an agreement to pay a certain sum of money upon the death of the person insured, in consideration of the due payment of a certain fixed annual sum or premium, during his life, and hence if the contract be valid at the time it was entered into, notwithstanding the fact that the interest of the creditor has ceased during the life of his debtor, he may still recover on the policy, though the result may be that he will be twice paid for his debt, once by his debtor and again by recovery on the policy. *Dalby* v. *Life Insurance Co.*, 15 Com. Bench, 365. The same construction of the contract has been approved and adopted by this court. *Emerick* v. *Coakley, et al.*, 35 Md. 193; *Whitney* v. *Independent Mutual Insurance Co.*, 15 Md. 326.

In support of the view taken by the appellee's counsel, cases have been cited in which it has been held that the assignee of a life policy, who has no insurable interest in the life, stands in the same position as if he had originally taken out the policy for his own benefit. In other words the contention is that the assured himself can make no valid absolute assignment of this policy to one who has no insurable interest in his life. But our own decisions are opposed to this. It

is settled law in this state that a life insurance policy is but a chose in action for the payment of money, and may be assigned as such under our Act of 1829, chap. 51. *New York Life Insurance Co.* v. *Flack*, 3 Md. 341; *Whitridge* v. *Barry*, 42 Md. 150. It is quite a common thing for the bond or promissory note of a private individual to be sold through a broker to a bona fide purchaser, for less than its face value; and when the latter takes an assignment of it, without recourse, he becomes its absolute owner, and is not bound to refund to the vendor anything he may recover upon it over and above what he paid for it. So a life policy being a similar chose in action may be disposed of and assigned in the same way, provided the assent of the insurer is obtained where it is so stipulated in the instrument.

In such case the assignee must of course keep the policy alive by the due payment of premiums if he wishes to realize anything from it. Such an assignment is valid in this state if it be a bona fide business transaction, and not a mere device to cover a gaming contract. Such is also the English rule. *Ashley* v. *Ashley*, 3 Sim. 149. These considerations prevent us from adopting some of the reasoning of the Supreme Court in *Warnock* v. *Davis*, 104 U.S. 775. It seems to us, with great deference, that from the facts in that case, the association, which was the assignee, could well be regarded as standing in the same position as if it had taken out the policy in its own name, and having no insurable interest in the life, it clearly became a wager policy. The assignment was made the day after the policy was issued in pursuance of an agreement to that effect made the day of its issuance. The assignment was evidently a mere device to cover up a gaming transaction. In the preceding case of *Cammack* v. *Lewis*, 15 Wallace, 643, the debt due the creditor was only $70 and the policy was for $3,000, confessedly without consideration. In view of these facts the Court well said "it was a sheer wagering policy and probably a fraud on the insurance company. To procure a policy for $3,000 to cover a debt of $70 is of itself a mere wager. The disproportion between the real interest of the creditor and the amount to be received by him, deprives it of all pretence to be a bona fide effort to secure the debt, and the strength of this proposition is not diminished by the fact that Cammack was only to get $2,000 out of the $3,000, nor is it weakened by the fact that the policy was taken out in the name of Lewis and assigned by him to Cammack." It was "under these circumstances" that the court held that Cammack

could hold the policy only as security for the debt due him when it was assigned, and such advances as he might afterward make on account of it.

If such then be the nature of a life insurance contract, and if a bona fide assignee for value, though a stranger, may recover and hold the whole amount for his own use, why may not a creditor who in pursuance of a bona fide effort to secure payment of his debt, insures the life of his debtor and takes the policy in his own name or for his own benefit, be entitled to hold all he can recover? He is in fact the owner of the policy, takes the risk of the continued solvency of the insurance company, and is obliged to keep the policy alive by paying the annual premiums during the life of the debtor, and the latter is under no obligation to do anything, and in fact does nothing in this respect. If he pays the debt to his creditor he has only discharged his duty, and what interest has he in the policy, or in what his creditor may recover upon it? In a recent English case it was held that a creditor who had insured the life of his debtor could retain all the sums he had received from the policies, without accounting for them to the representatives of the debtor, unless there was a distinct evidence of a contract, to the effect that the creditor had agreed to effect the policy, and that the debtor had agreed to pay the premiums, in which case only, will the policy be held in trust for the debtor. *Bruce* v. *Garden*, Law Rep., 5 Chancery Appeals, 32. This is the latest English authority to which we have been referred, and was decided by Lord Chancellor Hatherley on appeal. In that case the amount received from the policies by the creditor was nearly twice as much as the debt due him by his debtor.

We agree that there may be such a gross disproportion between the debt and the amount of the policy, as to stamp the transaction as indicating upon its face want of good faith, and as a mere speculation or wager. The case of *Cammack* v. *Lewis* affords an instance of such gross disparity, but no general rule on this subject has as yet been laid down by the courts, and it is probably better to leave each case to depend on its own circumstances. The disparity between the debt of $1,000 and $6,500, the aggregate of the sums named in the certificates, is certainly great, but upon examination it is more apparent than real. The answer, which we must take as true, shows bona fides on the part of the creditor. The policies were all in mutual aid associations where mortuary dues are paid by assessments and where of course the sum to be realized depends upon the number and

solvency of the members. One of the certificates for $2,000 contained a condition that only one-half should be paid if the assured should die within one year from its date, an event which actually occurred. Another expressly provided that he should receive an amount not exceeding $2,000, but according to the members liable to assessment on this certificate, and from that he received according to its terms only $250. Another of the associations was in financial difficulties and he compromised his claim on a certificate for $1,000, and received only $132.82. By taking out these certificates he became liable to be assessed as a member, and during the short time they were running (from June to the following March) he paid in this shape and in premiums the sum of $351.75. In view of the character of these certificates and of the associations by which they were issued, we cannot say the disproportion between the debt and the real amount and value of the insurances is so great in this case as to warrant a sentence of condemnation against the transaction as being a mere speculation or wager on the life of the debtor.

We shall therefore reverse the decree appealed from and dismiss the appellee's bill.

QUESTIONS

1. X borrows $1,000 from P, to be repaid in two years. P insures the life of X in the sum of $1,500 to secure the debt. At the end of the year, X pays the debt to P. P, however, continues to pay the premiums on X's life until his death, three years later. P is suing the insurer on the policy. What decision?
2. P insures the life of X for $1,000. Two years later, X borrows $1,000 from P. X dies without having paid the debt. P is suing the company on the policy. What decision?
3. P made a nominal loan of $500 to X so that he could insure X's life, which he immediately did in the sum of $3,000. X lived forty years, during which time P paid premiums, amounting to about $2,500. This is an action by P on the policy. What decision?
4. X borrows $5,000 from P which he agreed to repay in five years. P immediately insures X's life for $15,000. A year later, X died without having repaid any of the money advanced to him by P. P sues on the policy. What decision?
5. Suppose that P recovers the full amount of the policy in the foregoing case, is he under any obligation to account to the personal representative of X for any part of the proceeds of the policy?
6. Some courts hold that a creditor may insure the life of the debtor in an amount equal to the sum of the debt, all premiums payable during

the debtor's life expectancy, and interest on the premiums and debt for that period. Does this rule seem sound?

7. A, B, and C are partners, engaged in the hardware business. Each takes out insurance on the lives of the others. Are these policies valid?
8. D owes C $1,500. G is guarantor of the debt. Has G an insurable interest in the life of D? If so, in what amount may he insure D's life?
9. P, a stockholder in the X Company, insures the life of X, the president of the company. X dies. P brings an action against the insurer on the policy. What decision?

c) Concealment, Misrepresentation, and Fraud

PENNSYLVANIA MUTUAL LIFE INSURANCE COMPANY *v.* MECHANICS SAVINGS BANK & TRUST COMPANY

72 Federal Reporter 413 (1896)

TAFT, CIR. J. Coming now to the American authorities, we find very early in reported cases a disposition to depart from the strict rules of marine insurance law in the consideration of fire and life policies. In *Loan Co.* v. *Snyder*, 16 Wend. 481, Chancellor WALWORTH delivering the opinion of the Supreme Court of Errors of New York, refers to the peculiar rule of construction applied to that "anomalous and informal instrument called a 'marine policy,'" and expresses the opinion that it is not to be applied in its strictness to fire policies. The same view is expressed in *Jolly's Adm'rs* v. *Baltimore Equitable Society*, 1 Har. & G. 295, by the Court of Appeals of Maryland. In *Burritt* v. *Insurance Co.*, 5 Hill, 188, BRONSON, J., speaking for the Supreme Court of New York, after referring to the rule by which nondisclosure of material facts avoids a marine policy, although no inquiry be made, and although it is the result of innocent mistake or inadvertence said: "But this doctrine cannot be applicable—at least, not in its full extent—to policies against fire. If a man is content to insure my house without taking the trouble to inquire of what materials it is constructed, how it is situated in reference to other buildings, or to what uses it is applied, he has no ground for complaint that the hazard proves to be greater than he had anticipated, unless I am chargeable with some misrepresentation concerning the nature or extent of the risk. It is therefore the practice of companies which insure against fire to make inquiries of the assured, in some form, concerning all such matters as are deemed material to the risk, or which may affect the amount of the premium to be paid. This is

sometimes done by the conditions of insurance annexed to the policy, and sometimes by requiring the applicant to state particular facts in a written application for insurance. When thus called upon to speak, he is bound to make a true and full representation concerning all the matters brought to his notice, and any concealment will have the like effect as in the case of a marine risk."

The use of "concealment," in this last passage, should be remarked. It means there a failure fully to answer a question put. It is not a mere silence upon a matter not made the subject of inquiry. It is necessary to determine in which sense the word is used in decided cases, before their bearing on the present question can be clearly understood. Here we are considering only the duty of the insured in respect to something not inquired about. The Supreme Court of the United States in *Clark* v. *Insurance Company*, 8 How. 235, 249, suggests a distinction between fire and marine insurance, in reference to the obligation of the insured to speak when not inquired of, and cites in support of the Maryland and New York cases, just referred to. In *Gates* v. *Insurance Company*, 5 N.Y. 469, the Court of Appeals held that in case of a fire policy, where the insured makes a full answer to all the questions put to him, he is not answerable for an omission to mention the existence of other facts, about which no inquiry is made unless he withholds mention of them with intent to defraud. "He has a right to suppose that the insurer, in making inquiries in respect to particular facts, deems all other to be immaterial to the risk to be taken, or that he takes upon himself the knowledge or waives information of them." See, also, *Browning* v. *Insurance Co.*, 71 N.Y. 508; *Woodruff* v. *Insurance Co.*, 83 N.Y. 133; *Short* v. *Insurance Co.*, 90 N.Y. 16; *Haight* v. *Insurance Co.*, 92 N.Y. 55. In *Insurance Co.* v. *Harmer*, 2 O. St. 452, which was a fire insurance case, the defense was made that, previous to the issuing of the policy, there had been a fire in the insured premises, which had not been disclosed to the insurer. The court charged the jury that, if they found the circumstances material to the risk, the policy was void, "whether concealment resulted from fraud, accident or mistake." Judge RANNEY—one of Ohio's greatest judges—presided at the circuit in this cause, and delivered the opinion of the Supreme Court. In the Supreme Court he expressed the view that he was in error in his charge, in thus enforcing the rule of marine insurance in a fire insurance case. Such an expression of opinion is not necessary to a conclusion in the case, but the high standing of the judge gives great weight

to even his *obiter dictum*. He said: "It is not now true, whatever may be thought of the older authorities, that there is no difference in this respect (i.e., as to the rule of concealment) between marine and fire insurance, nor that a failure to disclose every fact material to the risk, upon which information is not asked for, or suppressed with a fraudulent intent, will avoid a policy of the latter description. The reason of the rule, and the policy in which it was founded, in its application to marine risk, entirely fail when applied to fire policies. In the former the subject of insurance is generally beyond the reach, and not open to the inspection, of the underwriter, often in distant ports or upon the high seas, and the peculiar perils to which it may be exposed, too numerous to be anticipated or inquired about, known only to the owners and those in their employ; while in the latter it is, or may be, seen and inspected before the risk is assumed, and its construction, situation, and ordinary hazards as well appreciated by the underwriter as the owner. In marine insurance the underwriter, from the very necessities of his undertaking, is obliged to rely upon the assured, and has therefore the right to exact a full disclosure of all the facts known to him which may in any way affect the risk to be assumed. But in fire insurance no such necessity for reliance exists, and if the underwriter assumes the risk without taking the trouble to either examine or inquire, he cannot very well, in the absence of all fraud, complain that it turns out to be greater than he anticipated. And so are the latest and best authorities."

In Massachusetts, in the earlier authorities, the stringent rule of marine insurance as to concealments was declared applicable with all its rigor to fire policies. In *Curry* v. *Insurance Co.*, 10 Pick. 535, it was held that if the assured did not communicate facts within his knowledge which increased the risk, though he was not questioned concerning them and though he supposed the facts not to be material, the policy was void. This can hardly be reconciled with the later cases in the same court. In *Washington Mills Emery Manufacturing Co.* v. *Weymouth B. Mutual Insurance Co.*, 135 Mass. 503, the question was whether the failure to state that the insured did not own the land on which the building stood avoided the policy. No fraud appeared. The court said: "The defendant saw fit to issue this policy without any specific inquiries of the plaintiff as to the title of the land, and without any representation by the plaintiff on this point. It was its own carelessness, and it cannot avoid the policy without proving intentional misrepresentation or concealment on the part of

the plaintiff. An innocent failure to communicate facts about which the plaintiff was not asked will not have this effect": citing *Com.* v. *Hide and Leather Insurance Co.*, 112 Mass. 136; *Fowle* v. *Insurance Co.*, 122 Mass. 191; *Walsh* v. *Association*, 127 Mass. 383.

Nor does Chief Justice SHAW's definition of "concealment" in a fire insurance case seem to be as broad as that prevailing in marine insurance. In *Daniels* v. *Insurance Co.*, 12 Cush. 416, he said, in defining the term as used in a fire policy: "'Concealment' is the designed and intentional withholding of any fact material to the risk, which the assured, in honesty and good faith, ought to communicate to the underwriter. Mere silence on the part of the assured, especially as to some matter of fact which he does not consider it important for the underwriter to know, is not to be considered as such concealment."

The number of life insurance cases in which the question has arisen is small. In *Rawls* v. *Insurance Co.*, 27 N.Y. 287, the Court of Appeals held that, where an applicant for life insurance fully and truly answered all questions put to him by the company, the mere omission to state matter, though material to the risk, would not be a concealment, and would not affect the validity of the policy, because the applicant might presume that the insurer had questioned him on all subjects which he deemed material. In *Mallory* v. *Insurance Co.*, 47 N.Y. 52, 57, the same court sustained a charge to the jury, that, if the applicant did not conceal any facts, which, in his own mind, were material in making the application, the policy was not void. See, also, *Cheever* v. *Insurance Co.*, 4 Am. Law Rev. 155. In *Vose* v. *Insurance Co.*, 6 Cush. 42, the supreme judicial court of Massachusetts announced the principle, as applicable to life policies, that the concealment of a material fact will avoid the policy, though it is the result of accident or negligence, and not of design. The case did not call for the application of such a principle. The applicant was asked if he was afflicted with any disease. He answered that he was not. At the time he had consumption, and had experienced several of the premonitory symptoms. His answers were made the basis of the policy. It is probable that the term "concealment," as used in this case, refers to an incomplete answer to a general question, rather than a failure to volunteer a fact not asked for, because the court uses in the opinion language which is incorporated in the headnote as follows: "It is the duty of the insured to disclose all material facts within his knowledge. Although specific questions, applicable to all

men, are proposed by the insurers, yet there may be particular circumstances affecting the individual to be insured, which are not likely to be known to the insurers; and the concealment of a material fact, when a general question is put by the insurers, at the time of effecting the policy, which would elicit that fact, will vitiate the policy."

But whatever the effect of this case, we think the modern tendency, even in Massachusetts decisions, is to require that a non-disclosure of a fact not inquired about shall be fraudulent, before vitiating the policy; and, as already stated, this view is founded on the better reason. The subject is by no means as clear, upon the authorities, as could be wished, and the text-writers find much difficulty in reconciling the cases. May, *Insurance* (3d. ed.) secs. 202, 203, 207.

QUESTIONS

1. What rules does Justice TAFT announce in this case concerning the effect of concealment of material facts in the formation of contracts of insurance?
2. P applies for insurance on his house. In the application appear these questions, among others: "Is the property incumbered? If so, in what amount." P answers: "One mortgage." As a matter of fact, there were two mortgages on the house and land in question. P sues D, the insurer, for a loss under the policy. D asserts the right to avoid the contract. What decision?
3. In the foregoing case, P makes this answer to the question: "It is incumbered." In an action on the policy for a loss, D claims the right to avoid the policy on the ground of concealment by P. What decision?
4. P applies for insurance on his house. The insurer asks no questions whatsoever of P. P sues D on the policy for a loss. D contends that the policy is avoided because P failed to disclose the fact that the house was vacant at the time the application for insurance was made. What decision?
5. Someone had attempted to set fire to P's house; alarmed by this fact, he went immediately to D and applied for insurance on the house; he answered truthfully all questions put to him by D with respect to the risk but did not volunteer the information about the attempt on the part of someone to set fire to the house. In an action by P on the policy, the company contends that the policy is void because of the concealment of this material fact by P. What decision?
6. X, just before going to a hospital for a dangerous operation, effected insurance on his life without disclosing to the company the proposed

operation. X dies from the effects of the operation. What decision in an action by P's personal representative on the policy?

7. X, cashier of a bank, misappropriated $25,000 of the bank's money. Realizing that he would never be able to repay the money, X insured his life in a large amount for the benefit of his wife and children. After his suicide, his wife brings an action on the policy. What decision?
8. In question 2, P contends that the information asked for was not material to the risk. Is this contention well founded?
9. P applies for insurance on his life. He answers truthfully all questions asked him but fraudulently conceals the fact that his physician had recently informed him that he had organic heart trouble. As a matter of fact the doctor was mistaken in his diagnosis. A year later, P was killed in an automobile accident. What decision in an action by P's personal representative on the policy?

PROUDFOOT *v.* MONTEFIORE

Law Reports 2 Queen's Bench Cases 511 (1867)

COCKBURN, C. J. This was an action against the defendant, as chairman of the Alliance Marine Insurance Company, for the recovery of damages from the company in respect of the company not having delivered to the plaintiff a policy of insurance on certain goods shipped on board a vessel called the "Anne Duncan," pursuant to an agreement alleged by the plaintiff to have been entered into between him and the company, and in respect of the company not having paid the sum of money which the plaintiff alleges would have become due on such policy if the same had been so delivered.

The agreement was for insurance on a cargo of madder, lost or not lost, shipped at Smyrna, on a voyage from Smyrna to Liverpool, on board the ship, "Anne Duncan," for and on account of the plaintiff, and consigned to him by one T. B. Rees, of Smyrna.

The plaintiff, a merchant at Manchester and Liverpool, dealt largely in madders in the Smyrna market, and Rees, being resident at Smyrna, was employed by him at a salary of £800 a year to make purchases of madder on his account, and to ship and consign the cargoes to him. The cargo in question was purchased and shipped by Rees in the course of his employment as such agent. The ship, with the cargo on board, sailed from Smyrna on the twenty-first of January, 1861, but again brought up in the Gulf of Smyrna on the same day. She set sail again on the twenty-third, but was stranded in the course of that day, and became a wreck. The cargo became a total loss. Intelligence of the stranding of the ship was communicated to Rees

on the morning of the twenty-fourth. On the twenty-sixth, which was the first post day, he communicated by letter to the plaintiff the loss of the vessel; and the fact that though the cargo had been got out, yet as the vessel had had 12 feet of water in the hold, the greater part of the cargo would be seriously damaged. Having communicated this information, the letter proceeds thus: "I hope to goodness you are fully insured. On the twelfth instant I forwarded you invoice and weights of the shipment by her, which gave you plenty of time to effect insurance. Lloyd's agents have telegraphed the disaster, which will reach London before my letter of the nineteenth instant, inclosing bill of lading.[1] I did not dare telegraph to you, for when once you had the intelligence in hand you were prevented from insuring." On the thirty-first of January the plaintiff, after receipt of the letters from Rees of the twelfth and nineteenth of January, but prior to the receipt of that of the twenty-sixth, gave instructions to effect the policy, and the slip was signed on the same day by the company's agent at Manchester.

There was, therefore, no fraud or undue concealment by the plaintiff of a material fact within his personal knowledge. On the other hand, it is clear that the fact of the loss of the vessel and damage to the cargo might have been communicated to him by Rees by means of the telegraph, but was purposely kept back by the agent for the fraudulent purpose of enabling the plaintiff to insure. We think it clear, looking to the position of Rees as agent to purchase and ship the cargo for the plaintiff, that it was his duty to communicate to his principal the disaster which had happened to the cargo; and, looking to the now general use of the electric telegraph, in matters of mercantile interest, between agents and their employers, we think it was the duty of the agent to communicate with his employers by this speedier means of communication.

From the letter of the agent it appears that, but for the fraudulent motive for his silence, he would, in the ordinary course of his duty have conveyed the intelligence of the loss to his employer, and would have availed himself of the telegraph for that purpose.

Upon the above facts, the question arises whether the plaintiff, the assured, is so far affected by the knowledge of his agent of the loss of the vessel and damage to the cargo as that the fraud thus com-

[1] The telegram was received, and the loss published in Lloyd's list of the twenty-ninth of January; but neither the plaintiff nor the company's agent was aware of it.

mitted on the underwriter, through the intentional concealment of the agent, though innocently committed so far as the plaintiff is concerned, will afford a defence to the underwriter on a claim to enforce the policy.

Notwithstanding the dissent of so eminent a jurist as Mr. Justice STORY, we are of opinion that the cases of *Fitzherbert* v. *Mather* (1 T.R. 12) and *Gladstone* v. *King* (1 M. and S. 35) were well decided; and that if an agent whose duty it is, in the ordinary course of business, to communicate information to his principal as to the state of a ship and cargo, omits to discharge such duty, and the owner, in the absence of information as to any fact material to be communicated to the underwriter, effects an insurance, such insurance will be void, on the ground of concealment or misrepresentation. The insurer is entitled to assume, as the basis of the contract between him and the assured, that the latter will communicate to him every material fact of which the assured has, or, in the ordinary course of business, ought to have knowledge; and that the latter will take the necessary measures, by the employment of competent and honest agents, to obtain, through the ordinary channels of intelligence in use in the mercantile world, all due information as to the subject-matter of the insurance. This condition is not complied with where, by the fraud or negligence of the agent, the party proposing the insurance is kept in ignorance of a material fact, which ought to have been made known to the underwriter, and through such ignorance fails to disclose it.

It has been said, indeed, that a party desiring to insure is entitled, on paying a corresponding premium, to insure on the terms of receiving compensation in the event of the subject-matter of the insurance being lost at the time of the insurance, and that he ought not to be deprived of the advantage, which he has paid to secure, by the misconduct of his agent. But to this there are two answers: first, that as we have already pointed out, the implied condition on which the underwriter undertakes to insure—not only that every material fact which is, but also that every fact which ought to be, in the knowledge of the assured shall be made known to him—is not fulfilled; secondly, as was said by the court in *Fitzherbert* v. *Mather* (1 T.R. 12, 16), where a loss must fall on one of two innocent parties through the fraud or negligence of a third, it ought to be borne by the party by whom the person guilty of the fraud or negligence has been trusted or employed.

By thus holding, we shall prevent the tendency to fraudulent concealment on the part of masters of vessels and agents at a distance, in matters on which they ought to communicate information to their principles, as also any tendency on the part of principals to encourage their servants and agents so to act. For these reasons our judgment must be for the defendant.

QUESTIONS

1. Did the agent in this case have any authority to withhold from his principal information concerning the loss of the ship? If not, why should the plaintiff be charged with the consequences of his fraudulent concealment?
2. Suppose that the agent had sent a telegram to his principal concerning the loss of the ship, but that the insurance had been effected before the telegram had reached the principal, what would have been the court's decision?
3. P applies for insurance on his house. The company sends an agent, A, to examine the premises. A discovers a defective chimney in the building but does not report it to the company, for fear that the company will reject the risk. In an action on the policy, the company contends that the policy is void because of the fraudulent concealment of a material fact by A. What decision?
4. The D Company entered into a contract with W to insure the life of her husband, H. When the policy was delivered two days later, W did not disclose the fact that her husband had sustained a serious injury on the day before. H died from the effects of the injury. W sues on the policy. What decision?

DENNISON *v.* THOMASTON MUTUAL INSURANCE COMPANY

20 Maine Reports 125 (1841)

This was an action upon a policy of insurance against fire upon the plaintiff's dwelling house and store, in Washington block, in the city of Bangor, bearing date, January 5, 1837.

On the trial of the case, before SHEPLEY, J., the plaintiff introduced the policy of insurance, which was in the usual form. Among the conditions of insurance referred to, and made a part of the policy, was this: "No insurance will entitle the insured to any indemnity for loss or damage, if the description by the applicant of the building or property insured be materially false or fraudulent; or if any circumstance material to the risk be suppressed," etc.

In the application for insurance, in reply to the inquiry, "What distance from other buildings?" the answer given (so far as material to this case) was, "east side of the block, small one story sheds, and would not endanger the building, if they should burn." To the inquiry, "What are the buildings occupied for, that stand within four rods? how many buildings are there, to the fires of which this may in any case be exposed?" no answer was given.

A verdict was found for the plaintiff, subject to the opinion of the court whether the plaintiff, on this testimony, or so much of it as may be legally admissible, is entitled to recover; the defendants' counsel objecting to all that part of it relating to the condition of the fire department and its exertions, and the statements of its members and others relating to those matters. If the plaintiff is entitled to recover, judgment is to be entered on the verdict; and if entitled to recover interest from an earlier date than sixty days after affidavit furnished and notice annexed, the verdict is to be amended accordingly.

Whitman, C. J. A verdict was taken for the plaintiff subject to the opinion of the court, upon a report of the Judge, before whom the trial was had, of the evidence, and rulings by him made in the progress of the trial. And it is agreed, that such judgment shall be entered, either upon the verdict or upon non-suit, as the court may deem reasonable.

The action is upon a policy of insurance against fire, underwritten by the defendants, on the dwelling house of the plaintiff, situated in Bangor, which was consumed by fire. The defendants, for their defense, rely upon what they consider to have been a misrepresentation made at the time the policy was effected. The misrepresentation alleged is contained in the answer to a written interrogatory, propounded to the plaintiff, as to the distance of other buildings from the premises insured. The answer was in these words: "East side of the block are small one-story woodsheds, and would not endanger the buildings if they should burn."

In evidence it appeared that small sheds projected out from near the back part of the brick block of buildings (one of which was the house in question) twenty-four feet, being twelve feet in width, and eight feet stud; and leaving a passageway, in the rear of them, of fourteen feet wide, adjoining some two-story wooden buildings, standing on another street, forty-nine feet from the plaintiff's house, and in which the fire which consumed the plaintiff's house originated.

The first question which arises is, was this a misrepresentation, or was there a suppression of the truth tantamount thereto, and material to the risk. It does not seem to be necessary, in order to avail the defendants in their defense, that the misrepresentation or suppression of the truth should have been wilful. If it were but an inadvertent omission, yet if it were material to the risk, and such as the plaintiff should have known to be so, it would render the policy void.

In the case at bar, it has now been rendered undeniable, that the burning of the two-story buildings, on another street, endangered the plaintiff's house; and to the interrogatory propounded it now would seem that the existence of those buildings might with propriety have been stated. But this does not prove that, before the occurrence of the fire, it would have been deemed material to name them, as being near enough to put the plaintiff's house in jeopardy. It is not an infrequent occurrence, after a disaster has happened, that we can clearly discern, that the cause, which may have produced it, would be likely to have such an effect, while, if no such disaster had occurred, we might have been very far from expecting it. In this case it is essential to determine whether the plaintiff was bound to have known that a fire originating in the two-story wooden buildings, would have endangered the burning of his house. If as a man of ordinary capacity, he ought to have had such an apprehension, then he ought to have named those buildings in reply to the interrogatory propounded; for what a man ought to have known, he must be presumed to have known. This knowledge, in a case like the present, must have been something more than that by possibility a fire so originating might have endangered his house. This kind of knowledge might exist in regard to a fire originating in almost any part of a city like Bangor; for a fire originating in an extreme part of it, if the wind were high and favorable for the purpose, might endanger all the buildings, however remote, standing nearly contiguous one to another, to the leeward of it. Any danger like this could not have been in contemplation, when the interrogatory was propounded. Such buildings only as were so nearly contiguous as to have been, in case a fire should originate therein, productive of imminent hazard to the safety of the plaintiff's dwelling, could have been in view by the defendants. And the question is, were the two-story wooden buildings of that description?

In reference to this question, it may not be unimportant to consider, that the defendants, at the time when this policy was effected,

had an agent residing in Bangor, whose business it was to attend, in their behalf, to the applications for insurance from that quarter. It may be believed, that the selection of this individual was the result of knowledge with regard to his intelligence and capacity for such purpose. It was not, however, his business, perhaps, to prepare representations to be made by applicants for insurance. But it did so happen, that he assisted the plaintiff in preparing the answers to the standing interrogatories, one of which is the interrogatory before named, intended to produce a representation upon which to found the estimates of the propriety of assuming the risks proposed. He, it seems, examined the premises, looked at the wood sheds, and the two-story wooden buildings beyond them. To him it did not seem to have occurred, that the vicinity of those buildings was such as to render it necessary that the two-story wooden buildings should be named in answer to the interrogatory; for he, at the request of the plaintiff, penned the reply thereto as he thought proper.

It does not appear that any witness has testified that, anterior to the disaster, he should have anticipated such an event as within the range of probability. What other individuals of intelligence did not foresee to be likely to occur, could not be expected to know, he cannot be considered as culpable for not knowing. And what he could not be expected to apprehend, he could not be bound to communicate; and, in not communicating any such fact, he could not be considered as guilty of concealing it, even inadvertently, and much less wilfully.

As to the wooden sheds, they were named; and the description given of them is precisely in conformity to the truth. They were named, however, in connection with an opinion, that if they took fire, they would not endanger the house. There is, then, no misrepresentation with regard to their existence. The misrepresentation complained of, in reference to them, is merely in matter of opinion. But opinions, if honestly entertained, and honestly communicated, are not misrepresentations, however erroneous they may prove to be. That this opinion was uttered bona fide, and in perfect singleness of heart and purpose, may well be believed, and may fairly be deducible from the fact that it was expressed in concurrence with the unquestionable belief, at the time, of its correctness by the confidential friend of the defendants. An opinion so uttered, if not in good faith, might well be complained of, as it might tend to throw the defendants off their guard. In such case, it might tend to show a fraudulent design; and in connection with evidence of misrepresentation of facts, even

short of what otherwise might be necessary to vacate a contract, would be likely to have that effect.

But it is by no means clear, if the fire had not originated elsewhere than in the sheds, that it would have been attended with essential danger to the main building. The neighbors and firemen of the city might be expected to be able to extinguish a fire so originating. Such buildings are easily pulled to pieces; and an engine brought to bear upon them would do great execution. It may, therefore, even now be very questionable, whether the opinion complained of may not be adopted as well as founded to a very considerable extent at least.

As to the testimony of the witnesses, touching the condition of the fire department and its exertions, and whatever relates thereto, we see no ground, from thence arising, to question the correctness of the finding of the jury. The most that can be said of that part of the evidence is, that it is irrelevant, and not of a tendency to influence a jury one way or the other.

We are of opinion, therefore, that judgment must be entered upon the verdict, with interest as agreed.

QUESTIONS

1. What was the issue under consideration in this case? Was it whether there was a misrepresentation of fact or whether the fact misrepresented was material to the risk?
2. What is the effect of an innocent misrepresentation of a material fact in an ordinary simple contract? If a different rule is applicable to insurance contracts, what is the justification for it?
3. P, an applicant for insurance in his house, with intent to deceive the insurer, volunteered the information that he was the owner of the property. As a matter of fact X held a mortgage on the premises. P sues D for a loss under the policy. The court instructed the jury that a fraudulent misrepresentation of fact rendered the contract voidable even though the insurer did not rely on the misrepresentation. Judgment was given for D. P appeals and assigns the instruction as error. What decision?
4. P, in his application for insurance, was asked to state the value of the property. He valued the property at $5,000. This was an innocent overstatement of the value by $1,000. P sues D for a loss under the policy. The court instructed the jury that an innocent misrepresentation of a fact would not avoid the policy even though it was relied upon by the insurer in assuming the risk. Judgment was given for P. D appeals and assigns the instruction as error. What decision?
5. What is the test of the materiality of facts concerning which a misrepresentation may be made?

KIMBALL *v.* AETNA INSURANCE COMPANY
91 Massachusetts Reports 540 (1865)

Two actions of contract on policies of insurance issued by the defendants respectively upon a dwelling-house of the plaintiff in Bradford, dated January 17, 1862, and payable in case of loss to Jacob Kimball, mortgagee.

The judge ruled that the representations, if proved, would not constitute a legal defence, and instructed the jury to return verdicts for the plaintiff, which was accordingly done. The defendants alleged exceptions.

GRAY, J. The contract of insurance is a contract to indemnify the owner of certain property against certain risks. This contract is founded upon the representations previously made by the assured to the insurer. The condition and circumstances of the property are within the knowledge of the owner more than of the insurer, and must be truly represented by the former to the latter, in order that he may estimate the risk before entering into the contract. In making this representation, the utmost good faith is required. If an existing fact material to the risk is misrepresented by the owner to the underwriter, the minds of the parties never meet, they agree on no subject-matter to which the contract can attach, the contract founded on such misrepresentation never takes effect, the underwriter may treat it as a nullity, and the other party, unless chargeable with fraud, may recover back the premium. If representations, whether oral or written, concerning facts existing when the policy is signed, are false, it never has any existence as a contract, unless it contains in itself terms which expressly or by necessary implication waive or supersede the previous representations. If the representations are positive and not of mere opinion or belief, it matters not whether they are made at or before the time of the execution of the policy, nor whether they are expressed in the present or the future tense, if they relate to what the state of facts is or will be when the policy is executed and the risk of the underwriter begins. If the facts are then materially different from the representations, the whole foundation of the contract fails, the risk does not attach, the policy never becomes a contract between the parties. Representations of facts existing at the time of the execution of the policy need not be inserted in it; for they are not necessary parts of it, but as is sometimes said, collateral to it. They are its foundation; and if the foundation does not exist, the superstructure does not arise. Falsehood in such representa-

tions is not shown to vary or add to the contract, or to terminate a contract which has once been made; but to show that no contract has ever existed.

The word "representations" has not always been confined in use to representations of facts existing at the time of making the policy; but has been sometimes extended to statements made by the assured concerning what is to happen during the term of the insurance; in other words, not to the present, but to the future; not to facts which any human being knows or can know, but to matters of expectation or belief, or of promise and contract. Such statements (when not expressed in the form of a distinct and explicit warranty which must be strictly complied with) are sometimes called "promissory representations" to distinguish them from those relating to facts, or "affirmative representations." And these words express the distinction; the one is an affirmation of a fact existing when the contract begins; the other is a promise, to be performed after the contract has come into existence. Falsehood in the affirmation prevents the contract from ever having any life; breach of the promise could only bring it to a premature end. A promissory representation may be inserted in the policy itself; or it may be in the form of a written application for insurance, referred to in the policy in such a manner as to make it in law a part thereof; and in either case the whole instrument must be construed together. But this written instrument is the expression, and the only evidence, of the duties, obligations, and promises to be performed by each party while the insurance continues. To make the continuance or termination of a written contract, which has once taken effect, dependent on the performance or breach of an earlier oral agreement would be to violate a fundamental rule of evidence. A representation that a fact now exists may be either oral or written; for if it does not exist, there is nothing to which the contract can apply. But an oral representation as to a future fact, honestly made, can have no effect; for if it is a mere statement of an expectation, subsequent disappointment will not prove that it is untrue; and if it is a promise that a certain state of facts shall exist or continue during the term of the policy, it ought to be embodied in the written contract.

In the cases now before us, there was no representation that the house was already occupied, and no representation or agreement that it should be occupied the instant the policies took effect. The plaintiff's statement was that "the house would be occupied; that

he had a man in view who was going to occupy it." There is nothing to show that this statement was not made in the most perfect good faith. Giving it the strongest possible interpretation against the plaintiff, it was a promise that the house should be occupied within a reasonable time, and the policies attached as soon as they were made and continued in force until such reasonable time had elapsed. The policies, having once taken effect, cannot be terminated or avoided in the absence of fraud, by the subsequent breach of an oral agreement made before they were executed. The cases come exactly within the rule laid down by Chief Justice SHAW, and confirmed by the opinion of the whole court, in *Bryant* v. *Ocean Insurance Co.*: "The evidence offered was not admissible for any other purpose than to prove a fraudulent intent on the part of the insured to mislead the defendants and to induce them to take the risk, or to take it at a lower premium than they otherwise would have done; as a representation, not of a fact, but of an intention, it did not avoid the policy, unless made with a fraudulent intent; as it related solely to the employment of the vessel within the time for which she was insured, it was not of an independent or collateral fact affecting the risk, but was embraced in the terms of the contract, and must be considered as absorbed in the contract afterward formally executed, or as by mutual consent withdrawn and waived by the execution of the policy." 22 Pick. 201.

This subject illustrates the wisdom of the common law in taking for its guides judicial opinions, given after argument, under the responsibility of determining the rights of parties in actual controversies, rather than the theories of scholars and commentators, however learned or acute.

Exceptions overruled.

QUESTIONS

1. What is the difference between an *affirmative* representation and a *promissory* representation?
2. Suppose that the defendants could have shown that the plaintiff, at the time he made the statement under consideration, never intended that the house should be occupied, what would have been the decision of the court in this case?
3. P applied to D for insurance on a certain building. He orally promised that he would take out an equal amount of insurance in the X Company. This he failed to do. P sues D for a loss under the policy. What decision?

4. P applies for insurance on his house. He makes an innocent misrepresentation of a material fact. The company avoids the policy. P sues for the return of the premiums which he has already paid. What decision?
5. P applies for insurance on his life. P, with knowledge of its falsity and with intent to deceive the insurer, states that he has never consulted a physician about his health. What decision in an action on the policy by P's personal representative?

d) Operation of the Contract of Insurance

i. AS TO PARTIES

I) Assignees

CONTINENTAL INSURANCE CO. *v.* MUNNS

120 Indiana Reports 30 (1889)

MITCHELL, J. It is abundantly settled that upon a sale and transfer of property covered by a policy of insurance, and an assignment of the policy to the purchaser, duly assented to by the company, a new and original contract of indemnity arises between the insurance company and the assignee, which the latter may enforce without regard to what may have occurred prior to the assignment. The policy, it is said, in such a case, expires with the transfer of the estate, so far as it relates to the original holder, but the assignment and assent of the company thereto constitute an independent contract with the purchaser and assignee, the same in effect as if the policy had been reissued to him upon the terms and conditions therein expressed. *Wilson* v. *Hill*, 3 Metc. 66; *Fogg* v. *Middlesex, etc., Ins. Co.*, 10 Cush. 337; *Flanagan* v. *Camden, etc., Ins. Co.*, 1 Dutch. (N.J.) 506; *Cummings* v. *Cheshire, etc., Ins. Co.*, 55 N.H. 457; *Steen* v. *Niagara, etc., Ins. Co.*, 89 N.Y. 315; *Shearman* v. *Niagara, etc., Ins. Co.*, 46 N.Y. 526; *Hooper* v. *Hudson River, etc., Ins. Co.*, 17 N.Y. 424; *Ellis* v. *Council Bluffs Ins. Co.*, 64 Iowa, 507; Wood. *Insurance*, secs. 110, 366.

Where an estate is sold and the policy transferred to the purchaser and upon notice to the insurer he assents to it, a new and original contract of indemnity arises to the assignee, which he may enforce in his own name. The policy in such case expires with the transfer of the title to the estate, but the assent of the insurer to the assignment of the policy constitutes a new contract. *Pratt* v. *New York, etc., Ins. Co.*, 64 Barb. 589; Flanders, *Fire Ins.*, 412, 484; *Foster* v. *Equitable, etc., Ins. Co.*, 2 Gray, 216.

Aside from the prohibitory clause, policies of insurance, prior to any loss, are not, in their nature, assignable from one person to another without the express consent of the insurance company issuing them. They are therefore subject to the common-law rule, the effect of which is, that where the assignee of a contract gives notice of the assignment to the other party to the instrument, and the latter assents to it, the transaction constitutes a new engagement between one of the parties to the contract and the assignee of the other, the terms of which are regulated and fixed by the original contract. *Fogg* v. *Middlesex, etc., Ins. Co., supra; Wilson* v. *Hill, supra; Hooper* v. *Hudson River, etc., Ins. Co., supra;* Flanders, *Insurance*, 484.

In order that a policy of insurance may be effectual, the insured must have an interest in the property covered by the contract of insurance, not only when the contract is entered into, but when the loss occurs. If the interest in the property and the interest in the policy become separated, the operation of the policy becomes suspended, and if a loss occurs while the policy is thus suspended, no recovery can be had. An assignment of an insurance policy without a transfer of the property insured, would be an idle ceremony so far as transferring to the assignee any beneficial interest in the contract. On the other hand, the transfer of the property insured suspends the operation of the policy, which becomes inoperative for want of a subject-matter to act upon, until by the assignment and assent of the company a new contract of insurance, embodying the same terms and conditions as the old, arises between the latter and the purchaser. The contract of insurance thus consummated arises directly between the purchaser and the insurance company, to all intents and purposes the same as if a new policy had been issued embracing the terms of the old. In such a case no defence predicated on supposed violations of the conditions of the policy by the assignor will be available against the assignee. Until the latter himself does some act, or permits a condition of things to exist in violation of the terms of the policy, he is not in default. *Ellis* v. *State Ins. Co.*, 68 Iowa, 578 (56 Am. R. 865) and *Insurance Co.* v. *Garland*, 108 Ill. 220, are not opposed to the conclusions stated above.

QUESTIONS

1. P effects insurance on his house in the sum of $5,000. He assigns the policy to X. (*a*) X sues the insurer for a loss under the policy. (*b*) P sues on the policy. What decision in each case?

2. In the foregoing case, P sells the property to X but does not assign the policy to him. (*a*) X sues on the policy for a loss. (*b*) P sues on the policy. What decision in each case?
3. P sells the property to X and assigns the policy to him. X sues the insurer for a loss under the policy. What decision?
4. P insures his house in the sum of $5,000. He indorses on the policy, "In case of loss, pay the same to X," and delivers the policy to X. A loss occurs under the policy. X sues for the loss. What decision?
5. In the foregoing case, the insurer pleads and proves that P violated a condition in the policy by keeping gasoline on the premises. What decision in an action by X on the policy?
6. P sells the insured property to X and assigns the policy to him. The company assents to the assignment. P sues the company on the policy. What decision?
7. In the foregoing case, the company pleads that P, previous to the assignment, had violated a condition in the policy. What decision?
8. P effects insurance on a building which he owns. There was the following clause in the policy: "If the applicant shall mortgage or otherwise incumber the same without the consent of the company, the policy shall be void." P mortgaged the property to Y. Thereafter, he sold the property and assigned the policy, with the assent of the company, to X. X sues for a loss under the policy. The company contends that the policy is void because of the mortgage on the premises. What decision?

MUTUAL LIFE INSURANCE COMPANY OF NEW YORK *v.* ALLEN

138 Massachusetts Reports 24 (1884)

W. Allen, J. The contract of insurance was made and was to be performed in this state, and the money due upon it has been paid into court here; and the contract of assignment was made in this state between parties domiciled here. The validity and effect of the assignment, and the capacity of the parties to it, must be governed by the laws of this state. The only question which requires discussion is whether by that law the assignment is void for want of interest of the assignee in the life insured.

The policy, in consideration of an annual premium to be paid by Mrs. Fellows, assured the life of her husband for her sole use, and for her children, if she should survive her husband. The promise was to the assured, her executors, administrators, and assigns. The policy contained no reference to an assignment except the following: "N.B.—If assigned, notice to be given to this company." The policy was issued in 1855. In 1881, an assignment in the words

following, signed by Mrs. Fellows, her husband, and children (who were all of age) was indorsed upon the policy, "I hereby assign and transfer over unto George Allen, of Boston, all my right, title and interest in and to the within policy of life insurance, and all right that may at any time be coming to me thereon."

A more formal instrument of assignment, with a power of attorney to receive "all sums of money that may at any time hereafter be or become due and payable to us, or either of us, by the terms of said policy," was also executed by the same parties. The policy and assignments were delivered to the defendant Allen, and notice thereof given to the plaintiff. The consideration of the assignment was the payment of a sum of money by the assignee, and the discharge of certain notes held by him against Mr. Fellows. It is to be assumed, on the report, that the transaction was not, in the intention of the parties, a wagering contract, but an honest and bona fide sale of the equitable interest in the policy. The defendant Allen had no insurable interest in the life of Mr. Fellows except as his creditor by accepting the assignment in satisfaction of his debt, so that he is in the position of a bona fide assignee of the policy for valuable consideration without interest in the life insured, and the question between him and the assignor is which has the equitable interest in the policy.

The policy is a common form of what is called life insurance, and is a contract by which the insurer, in consideration of an annual payment to be made by the assured, promises to pay to her a certain sum upon the death of the person whose life is insured. To prevent this from being void, as a mere wager upon the continuance of a life in which the parties have no interest except that created by the wager itself, it is necessary that the assured should have some pecuniary interest in the continuance of the life insured. It is not a contract of indemnity for actual loss but a promise to pay a certain sum on the happening of a future event from which loss or detriment may ensue, and if made in good faith for the purpose of providing against a possible loss, and not as a cloak for a wager, is sustained by any interest existing at the time the contract is made. See *Loomis* v. *Eagle Ins. Co.*, 6 Gray 396, and *Forbes* v. *American Ins. Co.*, 15 Gray 249. Mrs. Fellows had an insurable interest in the life of her husband, and the policy to her was a valid contract to pay the sum insured to her upon the event of his death. This contract was a chose in action assignable by her. *Palmer* v. *Merrill*, 6 Cush. 282.

The policy was not negotiable, and her assignment could not, in this state, pass the legal, but only the equitable interest in the contract. The assignment was a contract between her and her assignee, to which the insurer was not a party. It purported to give to the assignee only the equitable interest of the assignor in the contract—the right to recover in the name of the assignor the sum which should come due to her under the contract.

The direction in the policy, that notice of an assignment of it should be given to the insurer, had no effect upon the character of the assignment, however its operation might have been limited had notice not been given. The assent of the insurer to the assignment would not make a new contract of insurance. Its only effect would be to enable the assignee to enforce in his own name, instead of the name of the assignor, the rights she held under the contract *McCluskey* v. *Providence Washington Ins. Co.*, 126 Mass. 306.

This distinction between the assignment of the interest of the insured in a policy, which is a contract between the assignor and the assignee only, and the transfer or renewal to a third person of a policy, which is a contract to which the insurer is a party, is illustrated in the case of fire insurance. That is strictly a personal contract of indemnity to the assured, and he, or his assigns in his name, can recover only an indemnity for actual loss to him. If he has no interest in the property insured at the time of the loss, he can recover nothing, and if he parts with his interest before a loss, he becomes incapacitated to recover upon the policy, and the policy ceases to insure anything and becomes void. *Wilson* v. *Hill*, 3 Met. 66. It follows that, where a purchaser of insured property would have the benefit of an unexpired term of insurance, it must be by a new contract with the insurer, and not by assignment from the insured. This is usually provided for in the policy, so that by its terms an assignment by the insured with the assent of the insurer will continue the policy to the purchaser; but in such a case there is a new contract of insurance with the purchaser upon his newly acquired interest, and he becomes the assured. But the assured in a fire policy can, while his insurance continues, assign his rights under the policy in the same manner as the insured in a life policy can do. In *Fogg* v. *Middlesex Ins. Co.*, 10 Cush. 337, CHIEF JUSTICE SHAW says, after referring to the kind of transfer just mentioned: "But there is another species of assignment, or transfer it may be called, in the nature of an assignment of a chose in action; it is this: 'In case of loss, pay the amount to A.B.' It is a contingent

order or assignment of the money should the event happen upon which money will become due on the contract. If the insurer assents to it, and the event happens, such assignee may maintain an action in his own name, because, upon notice of the assignment, the insurer has agreed to pay the assignee instead of the assignor. But the original contract remains; the assignment and assent to it form a new and derivative contract out of the original. But the contract remains as a contract of guaranty to the original assured; he must have an insurable interest in the property, and the property must be his at the time of the loss. The assignee has no insurable interest, prima facie, in the property burnt, and does not recover as the party insured, but as the assignee of a party who has an insurable interest and a right to recover, which right he has transferred to the assignee, with the consent of the insurers." See also *Phillips* v. *Merrimack Ins. Co.*, 10 Cush. 350.

If Mrs. Fellows had surrendered or forfeited her policy, and the contract between her and the insurer had become null, a new contract, by which the defendant Allen should have become the assured instead of Mrs. Fellows, might have required an insurable interest in him, though in the form of an assignment and a renewal or revival of the original policy. But the original policy has not been surrendered or forfeited, nor the contract in any way changed. Mrs. Fellows is still the assured, and the policy is supported by her interest in the life, and is in form payable to her. If the assignment is valid, it is payable to her in trust for the assignee; if void, for her own use. In no respect can the assignment affect the validity of the contract of insurance, or taint that as a wagering policy. The only question that can be raised is as to the assignment itself—whether, as between the parties to it, it is void as a gaming contract.

That a right to receive money upon the death of another is assignable at law or in equity will not be questioned. The right of Mrs. Fellows, under our law, to assign the equitable interest in the policy in question is not denied; but it is contended that she can assign it only to someone who has an insurable interest in the life of Mr. Fellows. We find no reason for this exceptional limitation of the right of assignment, which would allow Mrs. Fellows to assign her policy to Mr. Fellows, or his creditors or dependent relatives, but would forbid her to pledge it for her own debts, or sell it for her own advantage. If there is any such reason, it must be found in the contract of assignment itself, and irrespective of the rule that the

original contract must be supported by an interest in the life insured. That rule was satisfied. Whether a similar rule affects the contract between the assignor and assignee must depend upon considerations applicable to that contract alone.

One objection urged is, that it gives to the assignee an interest in the death of the person whose life is insured, without a counterbalancing interest in his life. It is true that every person who is in expectation of property at the death of another has an interest in his death, but it does not follow, and it not true, that the law does not allow the possession and assignment of such expectation, nor that an insurable interest is required in a life insurance for the purpose of protecting the life insured. The objection applies with equal force to the assignment of a provision made for one upon the death of another by deed or will as to the assignment of a like provision in the form of a life insurance.

The other objection urged is, that such transactions may lead to gaming contracts. This does not meet the question, which is whether such an assignment is in itself illegal as a wagering contract. Most contracts have an element of gambling in them. There is uncertainty in the value of any contract to deliver property at a future day, and great uncertainty in the present value of an annuity for a particular life, or of a sum payable in the event of a particular death, and such contracts and rights are often used for gambling purposes. The question is whether the right to a sum of money payable on the death of a person under a contract in the form of an insurance policy has any special character or quality which renders it less assignable than the right to a sum payable at the death of the same person under any other contract or assurance, or than a remainder in real estate expectant on such death. We see nothing in the contract of life insurance which will prevent the assured from selling his right under the contract for his own advantage, and we are of opinion that an assignment of a policy made by the assured in good faith for the purpose of obtaining its present value, and not as a gaming risk between him and the assignee, or a cover for a contract of insurance between the insurer and the assignee, will pass the equitable interest of the assignor; and that the fact that the assignee has no insurable interest in the life insured is neither conclusive nor prima facie evidence that the transaction is illegal.

Several cases have been cited as deciding that any assignment of a life policy to one who has no interest in the life is void.

We will notice them briefly. *Cammack* v. *Lewis*, 15 Wall. 643, and *Warnock* v. *Davis*, 104 U.S. 775 were both cases in which the policies were taken out, by the procurement of the assignees in order that they might be assigned to them, under such circumstances as that they might well be held to be in evasion of the law prohibiting gaming policies. The remark of Mr. JUSTICE FIELD in the latter case, that "the assignment of a policy to a party not having an insurable interest is as objectionable as the taking out of a policy in his name," was not necessary to the decision. In *Franklin Ins. Co.* v. *Hazzard*, 41 Ind. 116, the assured had failed to pay the premiums, and had notified the insurers that he should not keep up the policy. He afterward assigned it for $20, the insurer assenting and receiving the premiums. The assignment was held void, the court saying that such policies are assignable, but not "to one who buys them merely as matter of speculation without interest in the life of the assured." Neither of these cases decides, whatever dicta may have accompanied the decision, that all assignments without interest are illegal. The case last cited is affirmed in the case of *Franklin Ins. Co.* v. *Sefton*, 53 Ind. 380, in which CHIEF JUSTICE WORDEN, quoting from the opinion of the court in *Hutson* v. *Merrifield*, 51 Ind. 24—that "the party holding and owning such a policy, whether on the life of another or on his own life, has a valuable interest in it, which he may assign, either absolutely or by way of security, and it is assignable like any other chose in action"—says that it is not stated that it is assignable to a person incapable of receiving an assignment, and adds, "It may be added that where the policyholder dies before the death of the party whose life is insured, perhaps the administrator of the holder could, for the purpose of converting the assets into money and settling up the estate in due course of law, sell the policy to anyone who might choose to become the purchaser."

We think that the second ruling was correct, and that the fact that the assignee had no insurable interest in the life does not avoid the assignment. It is one circumstance to be regarded in determining the character of the transaction, but it is not conclusive of its illegality.

Decree for the defendant Allen.

QUESTIONS

1. X effects insurance on the life of her husband. After his death and seasonable notice of it to the company, she assigns the policy to P. P sues the insurer for the loss. What decision?

2. X effects insurance on his life and with the consent of the company makes a gratuitous assignment of the policy to P. P pays the premiums on the policy during X's life and after his death sues for the loss. What decision?
3. X is the holder of a policy of insurance on his life which provides that it is not assignable without notice to the company. X assigns the policy to P. No notice is given to the company of the assignment. P sues on the policy after the death of X. What decision?
4. X effects insurance on his life in the sum of $1,000. After paying the premiums of the insurance for two years, he assigns it to P, with the assent of the insurer. After X's death, P sues for the loss. The company contends that the policy is void because X, before making the assignment to P, had violated a condition in the policy. What decision?
5. P, a person of sporting tendencies, makes this proposition to X: "You are not going to live long and we can both make money on your life. Take out insurance on your life for $10,000 and I will give you $1,000 for the policy when it is issued." In pursuance of this agreement, X effected the insurance on his life and made the assignment to P with the consent of the company. After the death of X, P sues on the policy. The company contends that the policy is void. What decision?
6. What is the difference between the assignability of fire insurance contract and the assignability of a life insurance contract? Is there any justification for the difference?

II) Beneficiaries

GROSVENOR *v.* ATLANTIC FIRE INSURANCE COMPANY
17 New York Reports 391 (1858)

HARRIS, J. The contract of insurance is a contract of indemnity. To sustain an action upon such a contract, it must appear that the party insured has sustained a loss. This involves the necessity of an insurable interest at the time of the alleged loss. Without such interest the party insured cannot be damnified.

In this case, the contract was between the defendants and McCarty. The agreement was to insure Eugene W. McCarty against loss or damage by fire, to the amount of $7,000, on his three-story brick dwelling-house. But after the contract was made, and before the alleged loss, McCarty had sold and conveyed the property insured. At the time of the fire he had no insurable interest; of course, he has no claim for indemnity. No action, therefore, could be maintained upon the policy by McCarty.

But at the time the insurance was effected, the plaintiff in this action, Grosvenor, was the holder of a mortgage upon the premises

insured. As such mortgagee, he, too, had an insurable interest. The extent of that interest was the amount of his debt. To that extent he might have contracted with the defendants to indemnify him against loss by fire. The payment of his debt would as completely terminate the contract to insure as would the alienation of the property, when the contract is made with the owner.

The important inquiry in this case, is, to which of these classes does the contract in question belong? The action is brought by the plaintiff as mortgagee. The contract was made with McCarty, the mortgagor. But the policy provides that in case of loss, such loss should be payable to the plaintiff. What is the legal effect of this provision? Without it the plaintiff could have had no claim against the defendants for indemnity. Is this provision to be regarded as an appointment of the plaintiff to receive any money which might become due from the insurers by reason of any loss sustained by the mortgagor, or has it the effect to render the policy, which would otherwise be a contract to indemnify the mortgagor against a loss, a contract to indemnify the mortgagee? A determination of this question will also determine the rights of the parties to this action.

Were it not for one or two decisions in this state bearing upon the question, I should have little difficulty in pronouncing in favor of the former of these propositions. It seems to me to be very clear that it was the intention of all the parties that the interest of the mortgagor, and not that of the mortgagee, should be insured. It is stated in the policy that the property insured is the property of McCarty, and that he is the person insured. McCarty paid the premium. He made the contract. His interest as owner, and not that of the plaintiff as mortgagee, was the subject of the insurance. The plaintiff was merely the appointee of the party insured to receive the money which might become due him from the insurers upon the contract. The provision in the policy in this respect had no more effect upon the contract itself than it would if it had been provided that the loss for which the insurers should become liable should be deposited in a specified bank to the credit of the party insured.

Suppose that the plaintiff, although described in the policy as a mortgagee, had, in fact, held no mortgage, could it be pretended that the defendants might have avoided the policy on the ground that the plaintiff had no insurable interest? Or, suppose again, that after the contract had been made, the mortgage had been paid, could it be claimed that the contract to insure had also ceased? I presume

none will deny that, in either case, the contract would have continued in force for the benefit of the owner of the property insured. If so, it must have been because the interest of the mortgagor, and not that of the mortgagee, was the thing insured. I agree with the court below that "there is nothing in the language of the policy on which the court can adjudge that in legal effect it is a contract insuring the interest of the mortgagee as such, except in the provision which declares that the loss, if any, which occurs under the contract insuring the mortgagor's interest, shall be payable to the mortgagee. That provision merely designates a person to whom such loss is to be paid, and shows that he is a person who may have an interest in its being paid."

The undertaking to pay the plaintiff was an undertaking collateral to and dependent upon the principal undertaking to insure the mortgagor. The effect of it was, that the defendants agreed that whenever any money should become due to the mortgagor upon the contract of insurance, they would, instead of paying it to the mortgagor himself, pay it to the plaintiff. The mortgagor must sustain a loss for which the insurers were liable, before the party appointed to receive the money would have a right to claim it. It is the damage sustained by the party insured, and not by the party appointed to receive payment, that is recoverable from the insurers. (*Macomber* v. *The Cambridge Mutual Fire Ins. Co.*, 8 Cush. 133.) The insurance being upon the interest of the mortgagor, and he having parted with that interest before the fire, no loss was sustained by him, and, of course, none was recoverable by his assignee or appointee. The right of such a party being wholly derivative, cannot exceed the right of the party under whom he claims. (*Carpenter* v. *The Providence Washington Ins. Co.*, 16 Peters, 495; *Foster* v. *The Equitable Fire Ins. Co.*, 2 Gray, 216.)

I agree with the learned judges who delivered opinions upon the decision of this case in the court below, that there is no just ground for discrimination between this case and that of an assignment of the policy to a mortgagee to be held by him as collateral security for his debt, with the consent of the insurer. In either case the insurance is upon the interest of the mortgagor. The terms and conditions upon which indemnity may be claimed are agreed upon, and then the original parties further agree that when, by the terms and conditions of the contract, the insurers shall become liable by reason of a loss sustained by the party insured, the money shall be paid,

not to the party who has sustained the loss, but to his appointee or assignee for his benefit. Such an appointment or assignment ought not to be construed so as to vary, in any respect, the liabilities of the insurers upon their original contract. It is certainly true, as was said by Mr. JUSTICE WOODRUFF, that "when applied to other agreements for the payment of money, an assignment does no more than direct to whom it shall be paid when it shall become due."

Upon the merits of the question, I have already sufficiently expressed the convictions of my own judgment. The defendants contracted with McCarty, and not the plaintiff. They agreed, upon the performance of certain conditions, to pay for him to the plaintiff certain money. Some of these conditions were positive in their character; others negative. Certain things were to be done by the assured, and others things were not to be done. If all these conditions were performed, then if a loss occurred, the defendants agreed to indemnify him against that loss, to the extent specified in the policy, and he appointed the plaintiff, his creditor, to receive from the defendants the amount for which they were thus contingently liable. The terms of this contract have never been waived, relaxed, or modified. The defendants have shown an express violation of one or more of the conditions upon which their liability was to depend. And yet it has been adjudged, although it is evident that it has been done with reluctance and against the better judgment of the court making the decision, that the proof of these violations constituted no defence to the action.

The judgment should be reversed and a new trial granted, with costs to abide the event.

QUESTIONS

1. What was the issue under consideration in this case? How was it decided? What rule of law can be deduced from the decision?
2. X insures a building with the D Company for $5,000 and indorses on the policy, "Pay the loss, if any, to P, mortgagee." A loss occurs and P sues for it. What decision?
3. In the foregoing case, X sells the property, subject to the mortgage, to Y. What decision in an action by P for a loss under the policy?
4. X fails to pay the premiums when they fall due. P sues for a loss under the policy. What decision?
5. X keeps gasoline on the premises, contrary to a condition in the policy. What decision in an action by P on the policy?

6. D insures the house of X and agrees to pay the loss, if any, to P, the mortgagee, as his interest may appear. The house burns and P brings an action on the policy. What decision?
7. In the foregoing case, D pays the whole loss, without P's consent, to X. What are P's rights, if any, against the insurance company?

LEMON *v.* PHOENIX MUTUAL LIFE INSURANCE COMPANY

38 Connecticut Reports 294 (1871)

SEYMOUR, J. In January, 1868, the respondent issued a policy on the life of George C. Peterson, for $3,000. This was in the usual form of an endowment policy, and no question arises upon it. In November, 1868, this policy was surrendered and canceled, and at the request of the assured a new policy issued in its place, like the former in every respect except that it was payable to the petitioner, with whom the assured was under an engagement of marriage. The leading question in this case is whether the petitioner became the owner of this second policy.

It is not claimed that the mere fact of making the policy payable to Miss Lemon, without more, vested in her a complete title. It is conceded that so long as Mr. Peterson retained it in his own possession, he might control it as his own. On the other hand, it is not doubted that, if Mr. Peterson delivered it to Miss Lemon as a gift to her, such delivery would vest in her a complete title. The difficulty in the case is in determining whether, on the facts found, the policy may properly be regarded as having been in legal effect delivered to her. This is so much a mere matter of fact that the committee should have distinctly found it the one way or the other, but instead of a direct finding, we have a special statement of facts bearing on the question, and it is left to the court to decide the ultimate facts, by inference from this special statement. Neither the petitioner nor the respondent saw fit to remonstrate against the acceptance of the report of the committee. On the contrary the report is accepted without objection from either party; and we must dispose of the question as best we may with the light we have.

First, the fact that Mr. Peterson caused the policy to be made payable to Miss Lemon, indicates a settled purpose in his mind that she should have the benefit of it; and his acts immediately after will naturally be construed as intended to carry out such purpose. Second, when therefore the policy is by Mr. Peterson's order sent

to Miss Lemon's brother, we naturally regard it as sent to him for her, as depositary for her, and for her benefit, rather than as depositary for Mr. Peterson himself. Third, it appears from the committee's report that the intended change in the policy for her benefit was communicated to her before it was made, and that it was upon her suggestion that the policy was placed in the hands of her brother. Fourth, after the policy was changed and made payable to Miss Lemon, and sent to her brother, she was informed by Mr. Peterson of what he had done. Upon these considerations, in view of all the facts in the case, we think we must find that there was an executed gift of the policy to Miss Lemon, and that the delivery to her brother was as depositary for her.

In December, 1868, Mr. Peterson changed his mind in regard to this policy, and obtained possession of it from Mr. Lemon, by what means does not distinctly appear; but the committee's report gives no countenance to the idea that it was by fraudulent means, as charged in the bill. It does, however, appear that the possession was obtained without the petitioner's consent, and also that she had no knowledge of the second change of the policy now to be spoken of, until after Mr. Peterson's death.

In January, 1869, Mr. Peterson having, as before stated, obtained possession of policy number two, caused it to be surrendered, and a new one, number three, to be issued in its place, payable to Peter A. Peterson, a brother of George. George went south for his health which was failing, starting November 30, 1868, and he was not able to do business after that time till his death, October 19, 1869. His health was not such as to enable him to pass the necessary medical examination for a new policy in November, 1868, or afterward.

Upon these facts it is clear that the consideration for policy number three, was the surrender of policy number two. Mr. Peterson's health was such that number three would not have been issued, if the company had not been bound by number two. And in as much as policy number two belonged to the petitioner, it was her property that, without her consent, was used to procure number three. She is therefore equitably entitled to the benefit of this policy.

Mr. Peterson's money however, to the extent of the premium paid in January, 1869, is represented in policy number three; and to that extent Miss Lemon has no interest; and from the $3,000 due on the policy the amount of that premium and interest on it should be deducted, and the balance paid to the petitioner.

A question was made before us that Miss Lemon had not an insurable interest in Mr. Peterson's life. If she had undertaken to obtain, and had herself obtained an insurance on his life, that question might have arisen. But surely Mr. Peterson had an insurable interest in his own life, and he obtained the insurance upon it; and we know of no law to prevent him from making the policy payable in case of his death to the person to whom he was affianced; and if such policy is delivered as a gift to the party to whom payable, we know no law to prevent such gift from being effectual. In *Rauls* v. *American Life Ins. Co.*, 27 N.Y. 282, JUDGE WRIGHT says, "If the contract is with the party whose life is insured, he may have the loss payable to his own representatives, or to his assignee or appointee." Besides, the company treated policy number two as valid; it appears that policy number three was issued in consideration of the surrender of number two, as before stated, and the question now to be decided is not on the validity of number two, but whether Miss Lemon has an equitable interest in number three.

We advise the Superior Court to pass a decree in favor of the petitioner, to the extent and in the manner specified above. We ought however to say that it has not escaped our attention that the bill is not in its allegations precisely adapted to the facts as found by the committee, nor precisely to the grounds upon which relief is granted. But no point was made by the respondent on this account, and if any question had been made, we probably should have advised, as has been done in similar cases, that the bill be amended to correspond with the case as shown by the report of the committee.

In this opinion the other judges concurred; except CARPENTER, J., who dissented.

QUESTIONS

1. X insures his life with the D Company and designates P in the policy as beneficiary. P brings an action for the loss under the policy. The company relies on the following defenses: (*a*) that P furnished no consideration for the company's promise; (*b*) that the policy was never delivered to P; (*c*) that P had no insurable interest in the life of X; (*d*) that X practiced fraud on it in securing the policy; (*e*) that X failed to keep up the premiums on the policy during his life. Pass judgment on each defense.
2. X secures an insurance policy on his life in which P is named as beneficiary. At X's request and without P's knowledge or consent, the company makes B the beneficiary of the policy. After X's death; (*a*) P

sues the company for the loss under the policy; (*b*) B sues for the loss. What decision in each case?

3. The D Company issues a policy of insurance on the life of X in which P is designated as the beneficiary. P poisons X and brings an action on the policy for the loss under it. What decision? If P cannot recover the loss, is anyone in a position to recover it?
4. X takes out a policy of straight life insurance on his life and names W, his wife, as beneficiary. W dies and then X dies. The personal representative of each party is claiming the proceeds of the policy. To which of them should it be given?
5. Would your answer have been the same in the foregoing case, if the insurance had been endowment instead of straight life?
6. X insures his life in favor of W, his wife, and delivers to her the policy. He forges her signature to a letter, purporting to authorize the company to surrender the policy. The company, innocently relying on the letter, canceled the policy and sent its cash surrender value to X. After the death of X, W sues on the policy. What decision?
7. X effects insurance on his life and designates P as beneficiary. In the policy, X reserves the right to change the beneficiary at will. What is the nature of P's interest in the policy?

PULLIS *v.* ROBISON

73 Missouri Reports 201 (1880)

NORTON, J. This is a proceeding in the nature of a creditor's bill, instituted by certain creditors of James P. Robison, deceased, whose claims had been allowed by the probate court against his estate, to subject to the payment of said debts the proceeds of certain policies of insurance taken out on the life of said Robison, and made payable to his wife. The creditors suing are three in number, and each having brought a separate action, the three suits were consolidated and tried together. Three of the policies, the proceeds of which constitute the subject-matter of controversy, were issued by the Mutual Benefit Life Insurance Company, each of them being for $5,000, and dated, respectively, February 26, 1867, February 21, 1868, and May 12, 1870. The amount of annual premiums was as follows: $283 on the one dates in 1867, $263 on the one dated in 1868, and $289 on the one issued in 1870. The plaintiffs claim and allege in their bill that Robison was in embarrassed circumstances, and at the time the premiums were paid he was insolvent, and that said policies were donated to his wife, and were procured for the

purpose of hindering, delaying, and defrauding creditors. Defendant, Mrs. Henrietta Robison, to whom said policies were made payable, denies all the allegations of the bill, and asserts her right to the proceeds of the same.

Upon the trial of the issues thus tendered, the court found that said Robison was solvent at the time said policies were taken out, and remained solvent till about the year 1876; that the payment of the two last premiums on two of said policies amounting to $342.05, dated respectively in 1867 and 1868, which payment occurred in 1876, was made by Robison while he was insolvent, and that all payments of premiums anterior to 1876 were made by him when he was solvent. Upon this finding the court decreed that Mrs. Robison was entitled to the proceeds of the policies, less the amount of premiums paid by Robison when insolvent, with the interest thereon, and also decreed that Mr. Pullis, the plaintiff who first brought suit, was entitled to the whole amount of the premium paid in 1876 with its interest. From this judgment plaintiffs appealed to the St. Louis Court of Appeals, where the judgment was affirmed, and from this judgment they appealed to this court.

It is insisted, by counsel, that inasmuch as the payment made in 1876 kept the policies on foot and gave them vitality, the whole amount of the insurance money, or so much thereof as will be sufficient to satisfy their debts, should be so applied. We have not been cited to, nor have we been able to find any authority that goes to that extent, nor are we acquainted with any equitable principle on which the claim can be founded. How the insurance money, under the fact and circumstances of this case, should be apportioned, presents a question of some difficulty, especially so, as the authorities we have been able to examine are conflicting in the rules laid down. The case of *Landrum* v. *Knowles*, 22 N.J. Eq. 594, goes farther in support of plaintiffs' position than any which has fallen under our observation, and it falls far short of what is contended for by them. In that case the wife insured the life of her husband for the benefit of her children, and after paying the annual premiums for about ten years assigned the policy, in conjunction with her husband, to one of the husband's creditors in payment of the debt. After said assignment the wife ceased to pay the premiums, but they were paid for about nine years by the creditors. Upon the death of her husband the insurance money was claimed by the children on the one hand, and the assignee

on the other, and the chancellor decided that the children were entitled to the cash value of the policy at the time it ceased to be kept alive by the mother, and that the residue of the money due on the policy should be paid over to the assignee.

On the other hand, in the case of *Trough's Estate*, 8 Phila. 215, where Trough, having taken out a policy on his life, assigned the same, while solvent, to a trustee for the benefit of his children, and becoming insolvent thereafter, still continued to pay the premiums, in a contest for the insurance money between the children and Trough's creditors, the rule laid down that the only claim the creditors could sustain would be the amount of the premiums paid by Trough to keep the policy alive after he became insolvent.

The object of such rules being to do exact justice between the contending parties and to distribute the fund according to their rights, it appears to us that neither of the rules above accomplishes the object; and inasmuch as the insurance money in contest in this case was the product of all the premiums paid, we think a just distribution of it would be obtained by declaring that Mrs. Robison should be decreed to have so much of the fund as was produced by the payment of the premiums by her husband when solvent, and plaintiffs so much as paid by Robison when insolvent contributed to produce; that is, that plaintiffs are entitled to recover the same proportional part of the whole insurance money that the premiums paid by Robison when insolvent bear to the premiums paid by him when solvent. Giving effect to this rule in the disposition of the case, and accepting the fact found by the court that Robison, after his insolvency, paid $342.05 as being correctly found, and the further fact, as shown by the record, that Robinson had paid on two of said policies during his solvency premiums amounting to $4,650, plaintiffs would be entitled to recover the sum of $686.84, and Mrs. Robison the residue.

As plaintiff Pullis in the race of diligence was the first to file his bill, asking an appropriation of the fund to the payment of his demand, he has obtained a priority over the other creditors, and the said sum of $686.84 should be applied on his debt. *George* v. *Williamson*, 26 Mo. 193. The judgment will be reversed and cause remanded, with directions to the circuit court to enter up a decree in conformity with this opinion, directing the receiver in whose hands the fund has been placed, to pay first the costs of the suit, next, the sum of $686.84 to plaintiff Pullis, and next, the residue to defendant, Mrs. Robison.

QUESTIONS

1. On what theory were the creditors permitted to share in the proceeds of the insurance on the life of the deceased?
2. X effects insurance on his life in the sum of $5,000 payable to his estate. He dies insolvent, leaving a wife and two minor children. X's creditors are claiming the whole amount of insurance in satisfaction of their debts. What decision?
3. In the foregoing case, the insurance is payable to W, his wife. X dies insolvent. P, by whom X was employed during his life, claims the proceeds of the policy on the ground that the first and all subsequent premiums were paid with money embezzled from him. What decision?
4. X effects insurance on his life in favor of W. In the policy, X reserves the right to change the beneficiary at will. X dies, leaving insufficient property to meet all his debts. What are the rights of his creditors with respect to the proceeds of the insurance?
5. P makes a loan of $2,000 to X and insures X's life by way of security in the sum of $2,500. A year later, X discharges the debt. Six months later, X dies. Who is entitled to the proceeds of the policy?
6. X insures his life in the sum of $5,000. He assigns the policy to P to secure a debt of $1,000. X dies, without having paid the debt. Who is entitled to the proceeds of the policy?
7. In the foregoing case, X, having paid the premiums on the policy for two years sells and assigns the policy to P, a stranger, for $250. P pays the premiums on the policy until X's death, two years after the assignment. Who is entitled to the proceeds of the policy?

ii. AS TO OBLIGATION

I) The Risk Insured Against

JOHNSON *v.* BERKSHIRE FIRE INSURANCE COMPANY

4 Allen's Massachusetts Reports 388 (1862)

Contract upon a policy of insurance upon the plaintiff's barn and grain therein, issued by the defendants. A trial by jury was waived in the superior court, and the case was heard before AMES, J., who found the following facts:

In the afternoon of a hot day in a dry season in August 1859, during the time covered by the policy, the plaintiff and his son were unloading hay from a wagon and placing it in a shed adjoining the barn, and while so engaged were annoyed by bees whose nest was in a hollow place under the door at which they were pitching in the hay; and the plaintiff, finding that no hot water could readily be had,

undertook to smoke them out by thrusting a wisp of straw into their hole and lighting it with a match. A fresh breeze was blowing at the time; the building was very old, and covered on the outside with white wood boards; the barn adjoining was full of hay, and some hay was stored in the loft of the shed. After withdrawing the wisp of straw, and while attempting to extinguish it, the fire spread with great rapidity on the outside of the shed, and destroyed the property. It was admitted that there was no fraudulent intent on the part of the plaintiff. Upon these facts, the judge found that there had been a want of ordinary care, judgment, and discretion on the part of the plaintiff; that this default was the immediate and proximate cause of the fire; and that, although he acted in good faith, and the negligence and default on his part did not amount to recklessness and wilful misconduct, yet under the circumstances he was not entitled to recover.

The plaintiff alleged exceptions; and it was agreed that if the exceptions should be sustained, judgment should be entered for the plaintiff, for the amount of the policy.

Merrick, J. The defendants contend that the carelessness and negligence proved at the trial whereby the fire was caused, by which the barn and other property insured were destroyed, constitute a valid defence to this action. It is admitted that there was no fraudulent intent on the part of the plaintiff in the commission of the acts from which the fire immediately resulted. But it was found as a fact by the court, the parties having waived a trial by jury, that there had been an omission to exercise ordinary care, discretion, and judgment on his part; and it was thereupon determined that, although he had acted in good faith, and his negligence and default did not amount to recklessness or wilful misconduct, he was not entitled to recover indemnity in this action for his loss.

This determination was erroneous. It is said to have been formerly doubted whether in marine insurances underwriters were liable for losses by fire occasioned by the negligence or mismanagement of the master or mariners at sea, but that now it is the better and established doctrine that they are liable where the acts are not of a barratrous character, and that this is applicable in all cases of such loss whether occurring on land or at sea. 1 Phil. *Insurance* sec. 1049, 1096. And in Angell on *Insurance* sec. 125, it is stated as an indisputable proposition, that as applied to policies against fire on land the doctrine has for a great length of time prevailed that losses occasioned

by the mere fault of the insured or his servants, unaffected by fraud or design, are within the protection of the policies, and as such are recoverable from the underwriters. In *Shaw* v. *Robberds*, 6 Ad. & El. 75, it is said by the court that the object of insurance is to guard against the negligence of servants and others and that there is no ground of distinction between the negligence of strangers and others and that of the assured himself, and that in the absence of all fraud the particular cause of the loss is only to be looked at. And in *Huckins* v. *People's Ins. Co.*, 11 Fost. (N.H.) 238, it is distinctly held that carelessness and negligence as such cannot be held to be a defence to an action upon a policy of insurance; that, in the absence of fraud, it is only the proximate cause of the loss that is to be considered.

The same doctrine was recognized by this court in the case of *Chandler* v. *Worcester Ins. Co.*, 3 Cush. 328. It is there said that the general rule unquestionably is, that in cases of insurance against fire the carelessness and negligence of the agents and servants of the assured constitute no defence. The defendants in that case offered to show not only that the plaintiff had been guilty of negligence but also of gross misconduct. And the court in examining the case, where the facts upon which the allegation of the gross misconduct imputed to the party were not reported, expressed an opinion that it might be of such character, though not amounting to a fraudulent intent to burn the building, as to deprive the assured of his right to recover; and this for the reason assigned, that the misconduct might be such as to manifest a willingness, differing little from a fraudulent and criminal purpose, to commit such an injury. But the law makes a clear distinction between even gross negligence and fraud, and although the former may be evidence tending to show *mala fides*, it is not in fact the same thing. 1 Parsons on *Con.* 571. *Goodman* v. *Harvey*, 4 Ad. & El. 870. In the present case, there is nothing in the facts found to show either a fraudulent intent or any willingness on the part of the plaintiff to set fire to the building. On the contrary it is conceded that he acted in good faith. And although his conduct was very imprudent, it is obvious, as well from his purpose as from his efforts to prevent the conflagration when the fire began to kindle, that he was actuated by no improper motive. These facts show a case of mere negligence, and therefore are not sufficient to preclude him from his right to recover on the policy an indemnity for his loss.

Exceptions sustained.

QUESTIONS

1. What rule of law is laid down by the principal case? Is there any justification for the doctrine of this case? Is any social utility served by protecting a person against the consequences of his own negligence?
2. P, acting in a "grossly negligent" manner, sets fire to an insured building and brings an action on the policy. What decision?
3. P intentionally sets fire to his building and sues on the policy for the loss. What decision?
4. The building accidentally catches fire. P stands by and watches it burn without making any effort to extinguish it or to remove its contents. What decision in an action by him on the policy?

CANNON *v.* PHOENIX INSURANCE COMPANY

110 Georgia Reports 563 (1900)

LEWIS, J. The contract between the parties stipulates that if a fire occur the insured shall give immediate notice of any loss thereby in writing to the company, and, in sixty days after the fire, shall render a statement to the company, signed and sworn to by the insured, stating the knowledge and belief of the insured as to the time and origin of the fire, etc. It is further stipulated that no suit or action on the policy for the recovery of any claim shall be sustainable in any court of law or equity, until full compliance by the insured with this requirement. Under the stipulations in the policy there can be no question that, as a condition precedent to the payment of the loss, the proofs of loss should be submitted to the company within the time prescribed. *Southern Home Assn.* v. *Home Ins. Co.*, 94 Ga. 167–69. The sufficiency of such proofs on the trial of the case is a question for the court, and, to be sufficient, they should show a loss within the terms of the policy. *Travelers Ins. Co.*, v. *Sheppard*, 85 Ga. 751–761–64. The question then is whether the proofs of loss submitted in this case were within the meaning of this policy.

It seems that in arranging the stove on the ground floor of the building the day before the damage, the pipe, which extended through the ceiling of the second floor, became disengaged at that ceiling, and that, when the fire was built in the stove on the next morning, smoke and soot escaped from the pipe into the second-story room where the damaged goods were situated. The damage claimed, therefore, in the notice of the loss, was by reason of the smoke and soot, and of the water used in cooling the ceiling. It does not appear

from the proofs of loss that there was any fire in or about the building except in the stove where it was intended to be built. This fire did not spread from where it was built and intended to remain. It was, therefore, all the time during the alleged injury and damage to the goods, what is termed in the books a "friendly" and not a "hostile" fire. It is true that there is sound authority for the proposition that an insured can recover loss occasioned by smoke, soot, etc., thrown out by a fire; but we think in these cases it will be found that such a matter causing injury was the product of a hostile fire. If a fire should break out from where it was intended to be, and become a hostile element by igniting property, although it might not actually burn the property insured, yet if it caused injury thereto by smoke or heat, or other direct means, damages would be recoverable. But this is not the case.

In 1 Wood on *Fire Insurance*, sec. 103, the following principle is announced, directly applicable to the facts in this case: "Where fire is employed as an agent, either for the ordinary purposes of heating the building, for the purposes of manufacture or as an instrument of art, the insurer is not liable for the consequences thereof, *so long as the fire itself is confined within the limits of the agencies employed*, as, from the effects of smoke or heat evolved thereby, or escaping therefrom, from any cause whether intentional or accidental. In order to bring such consequences within the risk, there must be actual ignition outside of the agencies employed, not purposely caused by the assured, and these, as a consequence of such ignition, dehors the agencies." This seems to have been an early principle decided in England, and the author refers to that decision in a note to the text just quoted. See *Austin* v. *Drew*, 6 Taunt. 435. In the case of *Gibbons* v. *German Insurance Institution*, 30 Ill. App. 263, it was decided that an ordinary fire insurance policy does not cover a loss caused by escaping steam from a break in steam-heating apparatus. GARY, J., says in his opinion that in principle that case was the same as *Austin* v. *Drew*, where, by the omission to open a register in an upper story of a seven- or eight-story building, smoke and heat came into lower stories and caused damage. He quotes the following language from GIBB, C. J., in that case: "There was no fire except in the stove and the flue—as there ought to have been—and the loss was occasioned by the confinement of the heat. Had the fire been brought out of the flue, and anything had been burnt, the company would have been liable. But can this be said where the fire never was at all excessive, and was always confined within

its proper limits? This is not a fire within the meaning of the policy, nor a loss which the company undertakes to insure against. They may as well be sued for the damage done to drawing room furniture by a smoky chimney." In the language of GARY, J., in his opinion: "If the fire were a moral agent, no blame could be imputed to it. It was doing its duty and no more. The damage was caused by another agent who, undertaking to transmit the beneficial influence of the fire, broke down in the task." See case of *American Towing Co.* v. *German Fire Ins. Co.*, 74 Md. 25, and the able opinion of ALVEY, C. J., on p. 34. *et. seq.*

Neither is the plaintiff entitled to recover any damages caused by the water used in cooling a portion of the ceiling heated by the pipe. In the proofs of loss it is not claimed that anything was actually ignited by this heat, and it does not appear that the use of the water was necessary to prevent ignition.

It is contended that the court erred in refusing to allow plaintiff's counsel to show that, after making out their proofs of loss, they discovered that some of the laths and joists had actually become ignited and were charred. Even if this were true and damage were caused to the property of plaintiff by this ignition, it would not have been admissible in the trial of the present case, for the reason that no proof thereof had been made and presented to the company prior to the institution of this suit; and it does not appear from the record that this fact was not discovered by plaintiff before suit was brought. Besides, there was nothing in the testimony offered which in the least tends to indicate that any injury or damage was done the goods of plaintiff by virtue of the igniting or charring of the laths or joists of the building. It is not pretended even that the smoke and soot which injured the property proceeded from that fire. Our conclusion, therefore, is that the court did not err in rejecting the testimony offered, and in granting a non-suit.

Judgment affirmed.

QUESTIONS

1. What was the peril insured against by the policy under consideration in this case? Did not the plaintiff suffer damage by reason of this peril? If so, why was he denied a recovery?
2. Why was the plaintiff not permitted to show that some of the laths and joists about the flue of his house had been burned?
3. D insures the house of P "against all direct loss or damage by fire." P's house is struck by lightning and torn to pieces. P sues on the policy for the loss. What decision?

4. In the foregoing case, the stroke of lightning sets fire to the building and destroys it. What decision in an action by P on the policy?
5. P sues on the policy, alleging and proving that great damage was done to his house by reason of the explosion of the furnace boiler. What decision?
6. What is the difference between a *hostile* and a *friendly* fire? Against which is an insured protected by a fire insurance policy?

ERMENTROUT *v.* GIRARD FIRE INSURANCE COMPANY

63 Minnesota Reports 305 (1895)

MITCHELL, J. This action was brought on a policy issued by the defendant to the plaintiff Ermentrout, insuring him, to the amount of $1,000, for one year "against all direct loss or damage by fire," on his "brick, iron-roof, grain warehouse building, and bins therein, including foundations and all permanent fixtures," etc. The only other provisions of the policy involved on this appeal are as follows: "If a building or any part thereof fall, except as the result of fire, all insurance by this policy on such building or its contents shall immediately cease." "If fire occur, the insured shall give immediate notice of any loss thereby in writing to this company." "The sum for which this company is liable, pursuant to this policy, shall be payable 60 days after due notice, ascertainment, estimate, and satisfactory proof of the loss have been received by this company, in accordance with the terms of this policy."

When the plaintiff rested, the defendant moved to dismiss the action for the reason that plaintiff had failed to establish his cause of action, in that, first, it did not appear that the loss or damage was the direct result of fire; second, that it did appear that the plaintiff had not given immediate notice of the loss in writing to the company. The judge granted the motion, although placing his decision exclusively on the last ground. Of course, if the action should have been dismissed on either ground, the ruling of the court must be affirmed.

The insured building was adjacent to another used as a feed mill, the wall between them being a partition wall. There is no claim that any part of the insured building was actually ignited or consumed by fire. The fire was confined to the adjacent feed mill, which fell, carrying down with it the partition wall and a part of the elevator insured, and the question to which both the examination and the cross-examination of plaintiff's witnesses seem to have been directed was whether the fall caused the fire or the fire caused the fall. While

the evidence offered by plaintiff was not of the most convincing or satisfactory character, yet we think it was such that the jury might have found either way on the question. We think that, as the evidence stood when plaintiff rested, it would have justified the jury in finding that the feed mill caught fire before it fell, and that the fall was caused by the partial consumption of the feed mill, and the weakening of the partition wall by the fire. If such were the facts, then we think the falling of the insured building was a "direct loss or damage by fire," within the meaning of the policy.

The provision that, if the building fell, "except as the result of fire," the insurance thereon shall cease, was introduced into the policy by the insurer for its own benefit, and, under a familiar rule, must be construed, in case of ambiguity, most strongly against it. We think it has reference only to cases where the building might fall from some other cause than fire, as for example, defective construction, the withdrawal of necessary support, storm, flood, or other like cause—and fire thereafter ensued. But it was not intended to exclude cases where fire was the immediate or proximate cause of the fall. To render the fire the immediate or proximate cause of the loss or damage, it is not necessary that any part of the insured property actually ignited or was consumed by fire. This is so well settled that the citation of authorities in support of the proposition is unnecessary.

The question is, was fire the efficient and proximate cause of the loss or damage? Thus, in one case, where a house protected by a policy of insurance against damage by fire was injured by the falling of part of the wall of an adjacent house, in consequence of fire in the latter house, it was held that the fire was the proximate cause of the loss, and that the insurers were liable, although the house insured had never been on fire. *Johnston* v. *West of Scotland Ins. Co.*, 7 Shaw & D. Sct. Ct. Sess. 52. The word "direct," in the policy, means merely "immediate," or "proximate" as distinguished from "remote." Counsel for defendant cites, in support of a contrary view, some language used by way of illustration in *California Ins. Co.* v. *Union Compress Co.*, 133, U.S. 387, 416, 10 Sup. Ct. 365, 372, in which the court names "destruction through the falling of burning walls" as an instance of remoteness of agency. The question was not before the court, for in that case the insured property was physically burned by the direct action of fire. If the court meant what counsel claims, we cannot avoid the conclusion that the illustration was, to say the least of it, an unfortunate one.

Our conclusion is that the court was right in dismissing the action, on the ground that plaintiff had failed to give notice of loss as required by the policy.

Order affirmed.

QUESTIONS

1. D insures P's house against losses "caused directly and immediately by fire." P's house catches fire. Little damage is done to the building or its contents by the blaze; but great damage is done to the contents of the building by the fire department in extinguishing the blaze. What are the rights of P against D on the policy?
2. In the foregoing case, P and others remove the contents of the building to the street. The goods are damaged by exposure to the weather. In an action by P on the policy, P makes a claim for this damage as a loss under the policy. What decision?
3. In the foregoing case, P claims damage for goods stolen while the fire was being extinguished. What decision?
4. With the permission of the insurer, P stored gunpowder on his insured premises. Through the carelessness of a stranger, the powder was ignited; an explosion resulted, destroying P's building. P sues on the policy for the loss. What decision?
5. In order to prevent the spread of a serious conflagration, the city causes P's building, among others, to be dynamited. P sues D on his policy, insuring the building against "direct and immediate losses by fire." What decision?
6. P's house is in the path of a serious fire and will inevitably burn. He removes his goods therefrom and stores them nearby. T steals about $500 worth of the goods. P sues D on the policy for the loss. What decision?

THE AMICABLE SOCIETY *v.* BOLLAND

4 Bligh's Reports, New Series, 194 (1830)

The Lord Chancellor. The circumstances of the case are shortly these: In January, 1815, Henry Fauntleroy insured his life with the Amicable Insurance Society. In the month of May in the same year he committed a forgery on the Bank of England. He continued to pay the premiums upon his insurance for a considerable period of time. In the year 1824, he was apprehended and on the twenty-ninth of October in that year he was declared a bankrupt, and an assignment of his effects was made to the respondents. On the following day, the thirtieth of October, he was tried for his forgery; he was found guilty, sentenced to death, and in the month of November following was executed.

The question under these circumstances is this: whether the assignees can recover against the insurance company the amount of this insurance; that is to say, whether a party, effecting with an insurance company, an insurance on his life, and afterward committing a capital felony, being tried, convicted, and finally executed, whether, under such circumstances, the parties representing him, and claiming under him, can recover the sum insured in the policy so effected. I attended to the argument at the bar in conjunction with the Noble Lord Radnor now present, and we have both come to the conclusion that the assignees cannot maintain this suit.

It appears to me that this resolves itself into a very plain and simple consideration. Suppose that in the policy itself this risk had been insured against: that is, that the party insuring had agreed to pay a sum of money year by year, upon condition, that in the event of his committing a capital felony, and being tried, convicted, and executed for that felony, his assignees shall receive a certain sum of money—is it possible that such a contract could be sustained? Is it not void upon the plainest principles of public policy? Would not such a contract (if available) take away one of those restraints operating on the minds of men against the commission of crimes? Namely, the interest we have in the welfare and prosperity of our connections. Now, if a policy of that description, with such a form of conditions inserted in it in express terms, cannot, on grounds of public policy, be sustained, how is it to be contended that in a policy expressed in such terms as the present, and after the events which have happened, that we can sustain such a claim? Can we, in considering this policy, give to it the effect of that insertion, which if expressed in terms would have rendered the policy, as far as that condition went at least, altogether void?

Upon this short and plain ground, therefore, independently of the more complicated arguments referred to by the counsel at the bar, in the discussion of this case, I think that this policy cannot be sustained, and that the respondents are not entitled to recover. I submit, therefore, that the judgment of the court below ought, under these circumstances, to be reversed.

Judgment reversed.

QUESTIONS

1. X insures his life in favor of his wife. He was indicted, convicted, and executed for murder. W brings an action on the policy for the loss. What decision?

2. In the foregoing case, in her action on the policy, W offers evidence tending to prove that X's conviction was contrary to the evidence. Should the evidence be admitted?
3. W insures the life of her husband in her own favor. He is indicted, convicted, and executed for murder. What decision in an action by W on the policy?
4. D issues a policy of insurance to X, which provides that there can be no recovery if the insured meets his death while engaged in the known violation of the law. X sees D, his debtor, approaching, leading two horses. X, wishing to collect his debt, seizes the horses. D shoots him. This is an action on the policy by X's personal representative. What decision?
5. In the foregoing case, X attempts to rob Y. Y shoots him. What decision in an action on the policy?
6. X commits suicide. What decision in an action on the policy?

PATTERSON *v.* MUTUAL LIFE INSURANCE COMPANY

100 Wisconsin Reports 118 (1898)

This is an action to recover upon an insurance policy issued by the appellant July 20, 1895, upon the life of Alexander W. Patterson, and originally payable to the administrators, executors, or assigns of the insured. On the fourth of October, 1895, the policy was assigned with the consent of the company to the plaintiffs, who are the children of the insured.

Alexander W. Patterson was forty-nine years of age at the time of the issuance of the policy, and was then married to his second wife, by whom he had no children, the plaintiffs being his children by a previous marriage. The first year's premium upon the policy was paid, and the insured died by his own hand February 25, 1896. Proofs of the death were duly made.

A verdict for the plaintiffs was directed for the face of the policy, and from judgment thereon the defendant appeals.

WINSLOW, J. There was evidence tending to show that the deceased was sane when he shot himself; hence, the verdict having been directed, it must be assumed upon this appeal that such was the fact. Starting from this basis, the argument of the defendant is, in substance, (1) That intentional self-destruction while sane is not a risk covered by a policy of life insurance, even when there is no clause in the policy specifically exempting the company from liability for such death; (2) the incontestable clause does not cover such a

death, and, even if it be held to do so by its terms, such a stipulation would be void, as against public policy; (3) intentional self-destruction while sane is a crime, and hence the stipulation providing that death in violation of law is not a risk assumed by the company defeats a recovery.

Upon the first proposition, reliance is placed upon the recent decision of the Supreme Court of the United States in the case of *Ritter* v. *Mut. L. Ins. Co.*, 169 U.S. 139. In this case it was distinctly held that intentional self-destruction by the assured while sane is not a risk covered by a life insurance policy, even when the policy contains no exception as to such a death; and it was further said that such a risk could not legally be covered by a policy, because it would be against public policy to make such a contract. This was an action by the executors of the estate of the assured upon a policy payable directly to his executors, administrators, and assigns; and there was much evidence tending to show that the assured deliberately effected this, and a large amount of other life insurance, with the intention of committing suicide, and thus enriching his estate and paying his debts. Another and perhaps the only other direct adjudication to the same effect is the decision in the case of *Supreme Commandery K.G.R.* v. *Ainsworth*, 71 Ala. 436. The principle upon which these decisions rest is thus well stated in the last-named case: "Death, the risk of life insurance, the event upon which the insurance money is payable, is certain of occurrence. The uncertainty of the time of its occurrence is the material element and consideration of the contract. It cannot be in the contemplation of the parties that the assured by his own criminal act shall deprive the contract of its material element—shall vary and enlarge the risk and hasten the day of payment."

The authorities upon which these decisions are principally based consist of certain expressions of opinion contained in *Hartman* v. *Keystone Ins. Co.*, 21 Pa. St. 466; *Moore* v. *Woolsey*, 4 El. & Bl. 243; and *Amicable Soc.* v. *Bolland*, 4 Bligh (N.S.) 194, in only one of which cases, however, was the question directly in issue. Support for the proposition is also drawn from the well-established principle of the law of fire insurance, that, if the insured intentionally set fire to the property insured, and destroy it, he cannot recover for the loss. It is certainly not to be denied that the reasoning in favor of the proposition is cogent, and were the question a new one in the law, the argument would be well-nigh irresistible, especially where, as in the *Ritter Case*,

the policy runs in favor of the estate of the insured, and the proceeds will go to the enrichment of such estate, instead of to other beneficiaries. But it is by no means a new question, and there are numerous authorities which directly hold that, where life insurance is effected for the benefit of wife or children, suicide while sane is not a defense in the absence of a condition or exception to that effect in the policy. *Fitch* v. *Am. P.L. Ins. Co.*, 59 N.Y. 557; *Darrow* v. *Family F. Soc.*, 116 N.Y. 537; *Patrick* v. *Excelsior L. Ins. Co.*, 67 Barb. 202; *Mills* v. *Rebstock*, 29 Minn. 380; *Kerr* v. *Minn. M.B. Asso.*, 39 Minn. 174; *N.W.B. & M.S. Asso.* v. *Wanner*, 24 Ill. App. 357. This principle was stated as the law in *McCoy* v. *N.W. Mut. R. Asso.*, 92 Wis. 577, although it probably was not directly involved in that case. The American textbooks which treat of the subject very generally state this to be the law. 1 May, *Insurance* sec. 324; Niblack, *Ben. Soc. & Acc. Ins.* sec. 156; 3 Joyce, *Insurance* sec. 2653; 3 *Am. & Eng. Ency. of Law* (2d ed.) 1016. While these textbook citations may not be considered as very convincing, they certainly tend to show the general impression prevailing among the legal profession upon the subject, and that impression certainly prevailed in the Supreme Court of the United States when the case of *Life Ins. Co.* v. *Terry*, 15 Wall. 580, was decided; for in that case Mr. JUSTICE HUNT refers to the contrary dictum in *Hartman* v. *Keystone Ins. Co.*, 21 Pa. St. 466, as confessedly unsound. The fact that insurance companies have almost universally deemed it necessary to insert in their policies provisions exempting them from liability in case of suicide, "sane or insane," may perhaps also be considered as showing the general trend of opinion upon the subject in insurance circles; but, whether this deduction is to be properly drawn or not, we think it certain that the fact that life insurance policies universally contain this provision is of weight in determining the construction now to be placed upon a policy which omits all specific reference to suicide, and also ostentatiously contains a clause providing that it shall be absolutely incontestable for any cause save for non-payment of premiums or misstatement of age. What would an applicant for insurance be entitled to think was the meaning of such a policy, when presented to him, garnished with the usual and customary commendations of the average solicitor of insurance? Certainly he would not think that its legal effect was the same as that of a policy containing the usual provisions against suicide, sane or insane.

The policy before us was originally payable to the administrators, executors, or assigns of Patterson; but within a few days it was assigned, with the consent of the company, to the plaintiffs, his children, and so remained. After this assignment it was no longer a policy in favor of Patterson's estate, but in favor of his children, as beneficiaries, as much as though originally made payable to them. Under the decision of this court in *Foster* v. *Gile*, 50 Wis. 603, such a beneficiary has an actual, subsisting interest in the policy, subject to the right of the insured, who has paid the premiums, to vest it elsewhere, but until such action by the assured, the interest of the beneficiary is such a vested, subsisting interest as would pass to the administrator of the beneficiary in case of his death. Such being the case, it falls directly within the principle of the New York and Minnesota cases before referred to, which hold that, as against such a beneficiary, suicide of the insured while sane is not a defense, in the absence of a provision in the policy. Nor would the application of that principle to this case necessarily conflict with the *Ritter Case*, where the policy was in favor of the estate of the insured. It may well be in such a case that the intentional suicide of the insured while sane would prevent a recovery by his personal representatives, and yet not prevent a revocation in case of a policy in favor of beneficiaries who had a subsisting, vested interest in the policy, at the time of the suicide, and who could not, if they would, prevent the act of the insured.

In determining what rule should be adopted by this court in the present case, there are numerous considerations which deserve attention. It must be borne in mind that the suicide clause has become so universal in policies that its absence at once attracts attention. It can hardly be otherwise than that the agent soliciting insurance under such a policy as this would at once call attention to its apparent liberality, in that there was no suicide clause, and, further, that there was in addition an "absolutely incontestable" clause; and the average layman (not to say lawyer), in looking it over, would conclude that it was in fact a very favorable policy to the insured. These provisions are all carefully framed by the insurance company, and expressly framed to induce people to insure; and the principle is familiar and just that, when the policy is capable of two meanings, that which is most favorable to the insured is always to be adopted. *Utter* v. *Travelers' Ins. Co.*, 65 Mich. 545. In at least one state (Missouri) there exists a statute which prohibits the defense of suicide,

except when it was contemplated at the time of effecting the insurance, and makes void any contrary stipulation in the policy. R. S. of Mo., 1889, sec. 5855. This statute has been enforced by the courts of Missouri, and by the Circuit Court of Appeals of the United States, without apparent question as to its validity on the ground of public policy. *Keller* v. *Travelers' Ins. Co.*, 58 Mo. App. 557; *Knights' Templar & M.L.I. Co.* v. *Berry*, 4 U.S. App. 353, 50 Fed. Rep. 511. Bearing these things in mind, and while conceding the strength of the arguments upon public policy on which the *Ritter Case* is based, we still think, in view of the prior decisions cited above to the contrary of the rule there laid down, and the general apparent acquiescence in those decisions by the courts and by the people, that we ought to hold, in accordance with those decisions, that, in a case where third persons are beneficiaries, intentional suicide of the insured while sane does not avoid the policy, in the absence of any provision in the policy to that effect. Whether the rule would apply to a case where the personal representatives of the insured were bringing the action for the benefit of the estate of the insured is not decided, because that case is not before us. In so holding, it becomes unnecessary to consider the effect of the incontestable clause upon this branch of the case.

We now come to consider the effect of the clause providing that death "in consequence of, or in violation of the law," is not a risk covered by the policy. It is truly said that intentional suicide while sane was a felony at common law. It was punished by forfeiture of goods, but, as we do not inflict such punishments, it is now little more than the shadow of a crime. Technically, it is still a crime in this state, because we have retained the common law so far as it is not inconsistent with our laws and general situation, but it is not a crime within the ordinary meaning of the term, or any usual definition, because we have no statute punishing either suicide or attempted suicide. Mr. Bishop's definition of a crime (1 Bish. *New Cr. Law*, sec. 32) is "any wrong which the government deems injurious to the public at large, *and punishes through* a judicial proceeding in its own name." This was approved by this court in *Petition of Bergin*, 31 Wis. 383. Such is undoubtedly the general conception of a criminal offense, namely, a violation of law for which there is a punishment. Words are to be understood in their generally understood and accepted meaning. Now, as before said, the insurance company has deliber-

ately struck out the usual suicide clause from their policy, and put in an "absolutely incontestable" clause. Is it reasonable to say that they have in fact retained the suicide provision, artfully concealed under a form of words which not one person in a hundred would suspect meant to include it? We think not. The rule that in case of doubt or ambiguity the language used (being the company's own language) must be construed most strongly against it, again applies. Certainly, if this clause were held to include suicide, the language of the policy would be grossly misleading. *Kerr* v. *Minn. M.B. Asso.*, 39 Minn. 174. The New York courts have held suicide not a crime, because common-law crimes have been abolished in that state. *Darrow* v. *Family F. Soc.*, 116 N.Y. 537.

But it is further claimed by the defendant that the evidence tended to show a fraudulent scheme on the part of Patterson, when he took out his policy, to obtain insurance on his life for the purpose of thereafter committing suicide, and defrauding the company for the benefit of his children. Doubtless, this would be a good defense, if shown, unless it be cut off by the "incontestable clause." It would be a defense not based on the suicide alone, but on the whole fraud, of which the act of suicide was only the ultimate step. But the difficulty is that we have been unable to find any evidence which would justify the submission of that question to the jury. It is said that he falsely represented his state of health in his application, and concealed some of the grounds upon which he had previously made application for a pension. There does not seem to be much merit in the claim. He submitted himself for examination to the company's medical examiner, who reported that he had dyspepsia, and that he was only a second-class risk. The company had full notice that he was not in first-class health, because the insured himself stated in his application that he had dyspepsia, and had had malaria, and had applied for a pension on the ground of indigestion brought on by exposure in the army. Besides, the incontestable clause would seem to effectually bar this defense. If this clause be not altogether a glittering generality, put in for no purpose except to induce men to insure, it would seem that it must cover such misstatements or omissions as are here alleged. Such clauses have been upheld by various courts. *Wright* v. *Mut. B.L. Asso.*, 118 N.Y. 237; *Simpson* v. *Life Ins. Co.*, 115 N.C. 39. *Goodwin* v. *Provident S.L. Ass. Asso.*, 97 Iowa 226; *Kline* v. *Nat. B. Asso.*, 111 Ind. 462. We see no reason why an insurance company

may not take the risk of ascertaining for itself the condition of health of the insured.

Judgment affirmed.

QUESTIONS

1. Suppose that the policy in this case, had been payable to the estate of the insured person, what would have been the decision of the court in an action by the insured's personal representative on the policy?
2. D insures X's life, promising to pay W, his wife, $5,000, at X's death. Six months later, X, while sane, commits suicide. W sues for the loss under the policy. What decision?
3. X, badly in debt, insures his life in six different companies, in favor of his wife and children, in amounts aggregating $50,000. Within a month after effecting this insurance, X commits suicide. This is an action by W on the policy issued by D. What decision?
4. D issues a policy on the life of X, which provides that no recovery can be had on it if the insured takes his own life. X, in a fit of insanity, kills himself. What decision in an action on the policy by X's personal representative?
5. The policy in the foregoing case provides that no recovery can be had on it in case the insured takes his own life, sane or insane. X accidentally shoots himself while hunting. What decision in an action on the policy?
6. In the foregoing case, X, hopelessly insane, commits suicide. What decision in an action on the policy by X's personal representative?
7. What is meant by the "incontestable clause," referred to in this case? What is the purpose of it? Why do insurance companies incorporate it into their policies? What is its effect on defenses which the company may have to actions on the policy?

II) Warranties

ALABAMA LIFE INSURANCE COMPANY *v.* JOHNSTON

80 Alabama Reports 467 (1886)

SOMERVILLE, J. The question of most importance, which is raised by the rulings of the court in this case, is, whether the answers made by the assured to the questions contained in the application for insurance are to be construed as absolute *warranties*, or in the nature of mere *representations*.

The distinction between a warranty and a representation in insurance is frequently a question of difficulty, especially in the light of more recent decisions, which recognize the subject as one of growing importance in its relations particularly to life insurance. As a general rule, it has been laid down that a warranty must be a

part and parcel of the contract of insurance, so as to appear, as it were, upon the face of the policy itself, and is in the nature of a condition precedent. It may be affirmative of some fact, or only promissory. It must be strictly complied with, or literally fulfilled, before the assured is entitled to recover on the policy. It need not be material to the risk, for whether material or not, its falsity or untruth will bar the assured of any recovery on the contract, because the warranty itself is an implied stipulation that the thing warranted is material. It further differs from a representation in creating on the part of the assured an absolute liability whether made in good faith or not.

A representation is not, strictly speaking, a part of the contract of insurance, or of the essence of it, but rather something collateral or preliminary, and in the nature of an inducement to it. A false representation, unlike a false warranty, will not operate to vitiate the contract, or avoid the policy, unless it relates to a fact actually material, or clearly intended to be made material by the agreement of the parties. It is sufficient if representations be substantially true. They need not be strictly or literally so. A misrepresentation renders the policy void on the ground of *fraud;* while a noncompliance with a warranty operates as an express *breach* of the contract.

The mere fact that a statement is referred to, or even inserted in the policy itself, so as to appear on its face, is not alone now considered as conclusive of its nature as a warranty, although it was formerly considered otherwise. Whether such statement shall be construed as a warranty or a representation depends rather upon the form of expression used, the apparent purpose of the insertion, and its connection or relation to other parts of the application and policy, construed together as a whole, where legally these papers constitute one entire contract, as they must frequently do. Bliss on *Insurance*, sec. 43, *et seq.*, *Price* v. *Phoenix Mut. Ins. Co.* (17 Minn. 497).

In construing contracts of insurance there are some settled rules of construction bearing on this subject, which we may briefly formulate as follows:

1) The courts being strongly inclined againstf orfeitures, will construe all the conditions of the contract, and the obligations imposed, liberally in favor of the assured, and strictly against the insurer.

2) It requires the clearest and most unequivocal language to create a warranty, and every statement or engagement of the assured

will be construed to be a representation and not a warranty, if it be at all doubtful in meaning, or the contract contains contradictory provisions relating to the subject, or be otherwise reasonably susceptible of such construction. The courts, in other words, will lean against the construction of the contract, which will impose upon the insured the burdens of a warranty, and will neither create nor extend a warranty by construction.

3) Even though a warranty, in name or form, be created by the terms of the contract, its effect may be modified by other parts of the policy or of the application, including the questions and answers, so that the answers of the assured, so often merely categorical, will be construed not to be a warranty of immaterial facts, stated in such answers, but rather a warranty of the assured's honest belief in their truth—or, in other words, that they were stated in good faith. The strong inclination of the courts is thus to make these statements or answers, binding only so far as they are material to the risk, where this can be done without doing violence to the clear intention of the parties expressed in unequivocal and unqualified language to the contrary.

Many early adjudications may be found, and not a few recent ones also, in which contracts of insurance, and especially of life insurance, have been construed in such a manner as to operate with great harshness and injustice to policyholders, who, acting with all proper prudence, as remarked by LORD ST. LEONARDS, in the case of *Anderson* v. *Fitzgerald* 4 H.L.C. 507, had been "led to suppose that they had made a provision for their families by an insurance on their lives, when, in point of fact, the policy was not worth the paper on which it is written." The rapid growth of the business of life insurance in the past quarter of a century, with the tendency of insurers to exact increasingly rigid and technical conditions, and the evils resulting from an abuse of the whole system, justify, if they do not necessitate, a departure from the rigidity of our earlier jurisprudence on this subject of warranties. And such, as we have said, is the tendency of the more modern authorities.

QUESTIONS

1. What is the difference between a warranty and a representation?
2. What is meant when it is said that a warranty is "in the nature of a condition precedent"?

3. What is the effect of a misrepresentation of an immaterial fact? What is the effect of a non-compliance with a warranty concerning an immaterial fact?
4. What is the effect of a breach of warranty made in good faith by the insured?
5. What is the test for determining whether a given statement is a warranty or a mere representation? Is every statement made by the insured in the policy itself a warranty? Will a statement made in the application for insurance be construed to be a warranty?
6. The court says in this case that all statements will be construed liberally in favor of the insured. What is the justification for this rule of construction?
7. X insured his life with the D Company. In the policy it was stated that all answers in the application "are deemed material and are incorporated herein as a part of this contract." One question asked of the applicant was: "Have you ever sustained a serious injury?" The answer was in the negative. In an action on the policy, the company offered evidence, tending to prove that X, while a child, fell out of a cherry tree and sustained a serious injury therefrom. Should the evidence be admitted?
8. In the foregoing case, another question was: "Have you ever had medical attention? If so, when?" X, innocently but erroneously, answered in the negative. In an action on the policy, the company assigned this misstatement as a breach of warranty. What decision?

FOWLER *v.* AETNA INSURANCE COMPANY

6 Cowen's New York Reports 673 (1827)

Assumpsit, on a policy of insurance against fire; tried at the New York circuit, July 6, 1826, before EDWARDS, J.

The plaintiffs, at the trial, proved a policy executed by the defendants, on the stock in trade of the plaintiffs, contained in a two-story frame house, filled in with brick, situated at No. 152 Chatham Street, in the city of New York. It appeared that the house, No. 152 Chatham Street, was burned, with the plaintiffs' stock in trade; but that the house was a wooden building, with hollow walls and not filled in with brick. That one of the conditions attached to the policy was, that if any person insuring any building or goods at the Aetna Office, should describe the same otherwise than as they really were, so that the same might be insured at less than the rate of premium specified in the printed proposals of the company, such insurance should be void and of no effect. Evidence was given at the trial, on the question whether the plaintiffs have been guilty of fraud in pro-

curing an over valuation of the goods destroyed; and among other evidence, the judge allowed proof on the part of the plaintiffs of their good character. This was objected to, and made one point of exception by the defendants.

The defendants insisted that the description of the goods, as being in a house filled in with brick, was a warranty which must be strictly complied with. The judge so considered it; but he received evidence to show that the wrong description was either a mistake of the plaintiffs, or of the agent of the defendants; and charged the jury, that if the plaintiffs made no representation of the character of the property insured, but the agent of the company took it upon himself to describe it, the plaintiffs were not bound to answer for the error. That if the plaintiffs did make the description, but not fraudulently, for the purpose of getting insurance at a reduced rate, but through mistake, still they were entitled to recover. The defendants' counsel excepted to the decisions and charge of the judge. There was a verdict for the plaintiffs for $3,042.80.

SAVAGE, C. J. I think it very immaterial as regards this action whether the error in description arose from design or mistake. The question is, did this description amount to a warranty that the property answered the description? The judge at the circuit so considered it; and it was admitted on the argument, that if the principles of marine insurance are applicable to fire insurance, it is a warranty. In the case of *Stetson* v. *Mass. Mutual Fire Ins. Co.* (4 Mass. Rep. 337) SEWALL, J., lays down the law thus: "The estimate of the risk undertaken by an insurer must generally depend upon the description of it made by the insured or his agent. A mistake or omission in his representation of the risk, whether wilful or accidental, if material to the risk insured, avoids the contract." *Gates* v. *Madison Mutual Ins. Co.*, 3 Barb. S.C. Rep. 73; *Frost* v. *Saratoga Mutual Ins. Co.*, 5 Den. 154; *Gates* v. *Madison Mutual Ins. Co.*, 2 Comst. R. 43. For this, he cites 1 Marsh. on *Insurance* 335, 339. That writer states that a warranty being in the nature of a condition precedent, must be fulfilled by the insured, before performance can be enforced against the insurer; and whether the thing warranted was material or not, whether the breach of it proceeded from fraud, negligence, misinformation, or any other cause, the consequence is the same. 1 Marsh. 347.

In relation to the sale of personal property, it is held that a bill of parcels is not a warranty that the goods are what they are repre-

sented to be. 2 Caines, 48, and other cases down to the 20 John. 198. But in relation to policies of insurance, it is held that a description of a vessel is a warranty. For instance, the description of a vessel as Swedish is a warranty of her national character. Phil. on *Insurance* 125, and the cases there cited. 8 John. 237, 319.

No cases have been produced, to show that a description of property insured by a policy against fire, is to be construed differently from a description in a marine policy. I can perceive no reason why there should be a difference. "Insurance," says Lord Mansfield, "is a contract upon speculation." 3 Burr. 1909. "The special facts upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only; the underwriter trusts to his representation," etc. He says the insured need not state what the insurer knows; but the keeping back the true state of the property is a fraud.

In this case, the plaintiffs ought to have known the true state and condition of their house and have truly represented it. Not having done so, they fail in their action. The property burned is not the property insured.

This is not a case in which equities should be considered. It is a sort of gambling, a speculation upon chances; and the parties must be held strictly and literally to their contract.

I think the judge misdirected the jury and that a new trial should be granted.

QUESTIONS

1. What was the error committed by the lower court in its instructions to the jury? What instructions should have been given to the jury under the facts of this case?
2. What is the effect of a breach of warranty by the insured? How does the insurer take advantage of a breach of warranty on the part of the insured?
3. D issued a policy to P, insuring "stock contained in a brick building, with a tin roof, occupied as a storehouse." P sues for a loss under the policy. D pleads a breach of warranty and proves that at the time the policy was issued the building was only partly occupied as a storehouse. What decision?
4. D issued a policy of insurance to P on a building described as a "machine shop." As a matter of fact, the building was a barber shop. What decision in an action by P on the policy?

5. This was an action on an insurance policy. The defense was a breach of warranty. In the application, made a part of the contract, P stated: "A watchman is kept on the premises." D proved that the watchman was not there regularly and that he was absent on the night of the fire. What decision?

SMITH *v.* MECHANICS' FIRE INSURANCE COMPANY

32 New York Reports 399 (1865)

DAVIS, J. This action is brought on a policy of insurance of $2,500, issued by defendants to Alexander Smith, and by him duly assigned to plaintiff. The policy was upon one of several buildings adjoining or contiguous, and constituting an establishment known as "Smith's Carpet Factory." The risk came under the class of special hazards, and the premium was at the rates charged for that class. The property insured is described in the policy in these words: "$400 on his two story frame building used for winding and coloring yarn and for storage of spun yarn, situated at West Farms, Westchester county, New York, known as part of Smith's Carpet Factory, marked F on plan of premises filed in the office of the Brooklyn Fire Insurance Company; $1,600 on stock wrought and unwrought and in process of being wrought in the above building; $500 on machinery and fixtures in said building."

The policy also contained a clause in these words: "And it is agreed and declared to be the true intent and meaning of the parties hereto, that in case the above-mentioned premises shall, at any time after the making and during the time this policy would otherwise be in force, be appropriated, applied, or used to, or for the purpose of, carrying on or exercising therein any trade, business, or vocation denominated hazardous, or extra-hazardous, or specified in the memorandum of special rates in the terms and conditions annexed to this policy, or for the purposes either of depositing, storing, or keeping therein any of the articles, goods, or merchandise in the same terms or conditions denominated hazardous, or extra-hazardous, or included in the memorandum of special rates, except as herein expressly provided for, or hereafter agreed to by this corporation, in writing, to be added to, or indorsed upon this policy, then and from thenceforth so long as the same shall be appropriated, applied or used, these presents shall cease and be of no force or effect."

Among the subjects enumerated in the memorandum of special rates contained in the conditions annexed to said policy are "wool

mills, wheelwrights, and wool waste, and generally all mills and manufacturing establishments requiring the use of fire heat not before enumerated."

In October, 1861, the manufacture of carpets having been temporarily suspended under the pressure of the times, the insured placed in the building covered by the policy in suit, thirteen hand looms for weaving woolen army blankets, which looms were in part made from materials before used in manufacturing carpets, and partly from new materials. On the first of November, 1861, defendant, for an additional premium at an enhanced rate, consented that building "C," one of the several constituting the carpet factory, be occupied for weaving, fulling, and storage purposes, and gave privilege "to run the mill nights for the term of three months."

After this period the insured commenced weaving army blankets by hand power in the building insured by defendants, and continued that business until the whole establishment was destroyed by a fire, which occurred in January, 1862, and originated in another building. There was no evidence that the change in the use of the building increased the risk, and plaintiff offered to show that the risk was, in fact, decreased, but the evidence offered was excluded. It was proved that the process of "fulling" was never used in the manufacturing of carpets, but was a necessary part of the manufacture of blankets, and that it was not customary for carpet factories to be run nights. On the trial the plaintiff was nonsuited, and judgment entered thereon was affirmed at General Term.

The statement of the policy that the building insured was "used for windings and coloring yarn and, for storage of spun yarn" was undoubtedly a warranty of its then present use. (*Jenkins* v. *Chenango Mutual Ins. Co.*, 2 Denio, 75; *Wall* v. *The East River Ins. Co.*, 3 Seld. 370.) This is all that is settled by the foregoing cases. But there is no pretense that the building in this case was not used at the time of the insurance precisely as stated, and therefore, none for saying that the warranty was broken *in presenti*, as it was in the case cited. The only question, therefore, on this part of the policy, is whether it contains a warranty that the building, during the continuance of the policy, should be used only "for winding, coloring, and storing yarn, with the fixtures and machinery then in it." In *O'Neil* v. *The Buffalo Ins. Co.*, the premises were described as occupied by a certain individual as a private dwelling. The occupant moved from and ceased to occupy the house several weeks before the fire, and it

stood vacant when burned. This court held that the description in the policy must be regarded as a warranty of the fact that the person named was the occupant at the date of the policy, and nothing more. (3 Comstock, 122.) In *Catlin* v. *The Springfield Ins. Co.* (1 Sum. 435) the policy was on a dwelling-house "at present occupied by one Joel Rogers as a dwelling house, but to be occupied thereafter as a tavern, and privileged as such," it was held that there was no continuing warranty that the house should be occupied as a tavern or otherwise, and that the company were liable, although the building was destroyed while vacant, by foul means, which probably could not have occurred if it had been occupied. A distinction was made in the court below between the use of the word "occupied" and the word "used" in the description of policy as to the effect upon the question of continuing warranty; but to my mind the suggestion is without force. Both relate to the present actual use of the property, and are, when so applied, synonymous in intent and meaning. If the courts do not find a warranty in the phrase *occupied* in a particular manner, it would be overstraining to find one in the words, *used* in a specified way. If an insurance company desire to protect itself by a warranty as to future or continued use in the same manner as when insured, it may always do so by language, the object and meaning of which will be understood by both parties, and the court should not thus construe words which are fully satisfied as a description of a present use or condition, into a promissory warranty, unless the inference is natural and irresistible that such was the understanding and design of both parties. Where there is such a warranty as to future use, the designated use must continue, or the warranty will be broken, for courts have no right to say that the insured may abandon the particular use or occupancy, and allow the premises to lie vacant or idle; for the very act of requiring such a warranty is conclusive that the insurer considered the continuance of the designated use or occupancy material to the risk, and made the contract accordingly. In my opinion there was no continuing warranty of future use in the clause of the policy under consideration.

QUESTIONS

1. How could the insurance company, in this case, have protected itself against a change in the use of the insured building?
2. D issued a policy on a building "occupied as a dwelling-house." The building became vacant and three weeks later was consumed by fire. This is an action by the insured on the policy. What decision?

3. The D Company issued a policy of insurance on P's plant. It was stated in the policy that a night watchman would be kept on the premises. When the building burned there was no watchman on the premises. What decision in an action by P against D on the policy?
4. P's policy contained this statement: "Smoking is not allowed on the insured premises." Smoking on the premises was forbidden by P but was occasionally indulged in by employees in violation of orders. Six months later there was a fire caused by the smoking of the night watchman. What decision in an action by P on the policy?
5. Are statements contained in an application for insurance warranties? Can they be made warranties? If so, how?

III) Conditions

FAUST *v.* AMERICAN FIRE INSURANCE COMPANY
91 Wisconsin Reports 158 (1895)

MARSHALL, J. The main question presented on this appeal is whether the presence of a small amount of benzine on the premises for use in the repair shop rendered the contract of insurance void. Keeping in mind the undisputed evidence that the prohibited article was not kept as an article of merchandise for sale, but as an article usually and necessarily kept in operating the business of the repair department of the furniture store, which the policy expressly covered, we find abundant authority to support the general rule, which we adopt, that where a contract of insurance by the written portion covers property to be used in conducting a particular business, the keeping of an article necessarily used in such business will not void the policy, even though expressly prohibited in the printed conditions of the contract.

It must be recognized that there is some conflict in the authorities on this subject, but the great weight of authority fully sustains the rule as above stated.

In the light of the foregoing, obviously the contract of insurance which covered the building to be used as a repair shop in connection with the furniture store permitted all things necessary to the enjoyment of the property for such use. The clause in the written portion of the policy, "four hundred dollars on the stock of furniture, upholstery goods, and other merchandise, not more hazardous, usual to a retail furniture store," must be construed to cover merchandise kept in the trade in the furniture store, and the words "not more hazardous" to refer to such merchandise only and have no reference to the neces-

sary articles kept for use in the repair shop. The words "any usage or custom of trade or manufacture to the contrary notwithstanding" contained in the printed portion of the policy, so far as they would otherwise prohibit the necessary use of benzine in the repair shop, must be held to be controlled by the written portion of the policy, which expressly insures the building in part as a repair shop, this upon the presumption that must exist, that the parties intended that the repair shop as it was, and as it must necessarily continue to be if it continued at all, must be carried on with all usual and necessary incidents, and that as such it was protected by the contract of insurance; also by force of the well-established rule, that the written special description of the particular subject-matter, wherever inconsistent with the printed clauses of the policy, must control. *Citizens' Insurance Co.* v. *McLaughlin*, 53 Pa. St. 485; *Cushman* v. *N.W. Insurance Co.*, 34 Me. 487; *Archer* v. *Merchants' & M. Insurance Co.*, 43 Mo. 434. The construction we thus give the policy renders the contract just and reasonable, and carries out the obvious intention of the parties to it. Any other construction would lead to the absurd result that the prohibitory clause of the policy would absolutely prevent the carrying on of the business expressly permitted in the written portion. No such absurdity can be held to have been contemplated by the parties, unless the terms of the contract are such as not to permit of any other reasonable construction. As said in *Carlin* v. *Western Assurance Co.*, 57 Md. 515: "Where the contrary is not expressly made to appear, it is not to be presumed that when an insurance is effected with reference to an established and current business, whose protection is really the object of the insurance, such a narrow and stringent construction of the provisions of the policy was intended as will necessarily cause its serious embarrassment or suspension."

It follows from the foregoing that the judgment of the Circuit Court must be reversed and a new trial granted.

QUESTIONS

1. How could the insurer in the principal case have escaped the risk in question? Does the court's conclusion seem, on the whole, fair to the insurer?
2. D insured P's building. The policy contained a provision that in case the insured should store or keep gasoline or other extra-hazardous substances on the premises the policy should be void. P kept gasoline

in the building for sale. The building caught fire from a defective flue and burned. P sues for the loss. D sets up a breach of condition. What decision?

3. D issued a policy to P, containing this clause: "If the insured shall keep or use naphtha in the cotton mill without the consent of the company, this policy shall be void." P carried a small quantity of naphtha into the mill with which to exterminate some insects in the cotton. P sues for a loss under the policy. What decision?
4. D issued a policy to P "on his stock in trade, usually kept in a country store." There was a printed clause in the policy excepting gunpowder and naphtha from the risks assumed by the insurer. P kept a supply of each article on hand, as such things were usually carried by country stores. P sues on the policy. D pleads a breach of condition. What decision?
5. P effects insurance on whiskey which he keeps for sale in violation of law. P sues for a loss under the policy. What decision?
6. The standard policy contains a provision avoiding the policy in case it is assigned before loss without the consent of the company. What is the purpose of this provision?

ANGIER *v.* WESTERN ASSURANCE COMPANY
10 South Dakota Reports 82 (1897)

Action upon a policy of fire insurance. Plaintiff had judgment, from which, and from an order denying its motion for a new trial, defendant appeals. Affirmed.

CORSON, P. J. The second defense is based upon the following stipulation in the policy: "This entire policy shall be void if the hazard be increased by any means within the control or knowledge of the insured, or if (any usage or custom of trade or manufacture to the contrary notwithstanding) there be kept, used or allowed on the above described premises, phosphorus, petroleum, or any of its products of greater inflammability than kerosene oil of the United States standard (which last may be kept for light, and kept for sale according to the law, but in quantities not exceeding five barrels provided it be drawn and lamps filled by daylight, or at a distance not less than ten feet from artificial light)." Comp. Laws, sec. 4175, provides: "An insurer is not liable for a loss caused by the willful act of the insured: but he is not exonerated by the negligence of the insured, or of his agents or others."

The facts in regard to the origin of the fire are thus stated by the plaintiff Stevens on cross-examination, and are undisputed: "I took a tomato can, maybe two-thirds or half-full of kerosene oil, and put

some of the oil on the kindling. I turned to strike a match to set it afire. I had on a pair of celluloid cuffs, and the flame caught on my cuffs, and in a moment they blazed up. I had the can in my left hand and it fell on the floor, and the fire caught in the stove at the same time. I rushed out and tried to get my coat off."

As will have been observed, there is no clause in the policy prohibiting the plaintiff from keeping kerosene oil upon his premises to the extent of five barrels, United States standard, and there is no evidence that the oil used by plaintiff was below the prescribed standard. The quantity on hand at the time of the fire was less than one gallon. In view of the stipulation in the policy, the provisions of the statute, and the evidence, it is somewhat difficult to comprehend the theory of the defendant. It seems to be contended that the kerosene oil, used in the manner testified to by the plaintiff Stevens, increased the hazard, and therefore relieved the defendant from liability. Undoubtedly, the use of the kerosene in the manner detailed by the witness was a careless and negligent act, but it was not such an act as is understood by the term "increase of hazard." The stipulation of the policy is that "the entire policy shall be void if the hazard be increased by any means within the control or knowledge of the insured." Keeping kerosene upon the premises in no manner violated the stipulations of the parties, and could not therefore be held to constitute an increase of the hazard, within the meaning of the policy. The term "increase the hazard" denotes an alteration or change in the situation or condition of the property insured, which tends to increase the risk. These words imply something of duration, and a casual change of a temporary character would not ordinarily render the policy void, under the stipulations therein contained. *First Congregational Church* v. *Holyode Mutual Fire Insurance Co.*, 33 N.E. 572, 158 Mass. 475. In that case the Supreme Court of Massachussetts held the use of naphtha (the use or keeping of which on the insured premises was prohibited by the policy) for a period of a month, in burning paint from the outside of a wooden church, and causing the burning of the church, constituted such a change or alteration, and was sufficiently long continued to be deemed a change in the situation or circumstances affecting the risk. In *Lyman* v. *Insurance Co.*, 14 Allen 329, three weeks was held sufficient.

In the case at bar the contention of counsel for appellant that the use of kerosene at any one time, in the manner detailed, constituted an increase in the hazard, in the sense in which that term is

used in the policy, is not tenable. It, as we have said, constituted negligence on the part of the plaintiff, but did not increase the hazard in the sense that the term is used in the policies of insurance. But as we have seen, under the provisions of our statute, neither the negligence of the insured nor of his agents or others exonerates the insurer from liability. (Comp. Laws, sec. 4175.) This section of the Civil Code, as appears from the reviser's notes to the corresponding provision of the Code prepared for the state of New York, is based largely upon *Mathews* v. *Insurance Co.*, 11 N.Y. 9; *Gates* v. *Insurance Co.*, 5 N.Y. 469; *Walker* v. *Maitland*, 5 Barn. & Ald. 171; *Waters* v. *Insurance Co.*, 11 Pet. 213. In the latter case the Supreme Court of the United States, speaking by Mr. JUSTICE STORY, says: "This question has undergone many discussions in the courts of England and America, and given rise to opposing judgments in the two countries. As applied to policies against fire on land, the doctrine has for a great length of time prevailed that losses occasioned by the mere fault or negligence of the assured or his servants, unaffected by fraud or design, are within the protection of the policies, and, as much, recoverable from the underwriters. It is not certain upon what precise grounds that doctrine was originally settled. It may have been from the rules of interpolation applied to such policies containing special exceptions, and not excepting this; or it may have been, and more probably was, founded upon a more general ground, that, as the terms of the policy covered risks by fire generally, no exception ought to be introduced by construction, except that of fraud of the assured, which, upon the principles of public policy and morals, was always to be implied. It is probable, too, that the consideration had great weight that otherwise such policies would practically be of little importance, since comparatively speaking, few losses of this sort would occur which could not be traced back to some carelessness, neglect, or inattention of the members of the family." In *Gates* v. *Insurance Co.*, *supra*, the Court of Appeals of New York uses the following language: "But another question arises upon the evidence offered, namely, whether a loss occurring from the gross carelessness and negligence of the insured, his servants, or others, is within this policy. There can be no doubt that one of the objects of insurance against fire is to protect the insured from loss, as well against his own negligence as that of his servants and others; and therefore the simple fact of negligence in either, however great in degree, has never been held to be a defense in such a policy."

The facts in the case at the bar were undisputed, and we think the court properly directed a verdict in favor of the plaintiff. The judgment of the Circuit Court and order denying a new trial are affirmed.

QUESTIONS

1. Did not the conduct of the plaintiff materially increase the hazard insured against? If so, why was his conduct not held to be a breach of the condition under consideration?
2. D issues a policy to P, containing this clause: "If the hazard be increased by means within the control or knowledge of the insured, this policy shall be void." At the time the policy was issued, fire extinguishers were located in various parts of the building. P removed these without the consent of the company. P brings an action for a loss under the policy. D contends that the removal of the fire extinguishers constitutes a breach of condition. What decision?
3. This was an action on a policy of fire insurance containing this clause: "In case the assured premises shall be vacant for more than twenty days without the consent of the company, this policy shall be void." P and his family were absent from the premises for three weeks because of the sickness and death of a member of the family in a distant city. The company pleads this vacancy as a breach of condition. What decision?
4. The standard policy contains this provision: "This entire policy, unless otherwise provided by agreement indorsed hereon or added hereto, shall be void if the insured has or shall hereafter make or procure any other contract of insurance, whether valid or not, on property covered in whole or in part by this policy." What is the purpose of this provision?

DOLLIVER *v.* ST. JOSEPH FIRE INSURANCE COMPANY

128 Massachusetts Reports 315 (1880)

Soule, J. The plaintiffs are the assignees in bankruptcy of Abraham Day, who being the owner in fee of the buildings described in his policy, subject to certain mortgages and to a lease running for about three and one-half years, obtained the policy sued on; and, the building having been destroyed by fire, bring this action to recover the amount for which they were insured. The plaintiffs were appointed assignees after the loss. The defendant contended, and the Chief Justice at the trial ruled, that the action could not be maintained, because no mention is made in the policy of the incum-

brances on the title to the property destroyed. This ruling was based on the following provision of the policy: "4. If the interest of the assured in the property be any other than the entire, unconditional, and sole ownership of the property, for the use and benefit of the assured, or if the building insured stands on leased ground, it must be so represented to the company, and so expressed in the written part of this policy, otherwise the policy shall be void." This provision is in the body of the policy, and is inserted for the benefit of the insurer. It is to be construed strictly against it, and liberally in behalf of the assured. If, therefore, its terms can be satisfied by a construction which will save the policy, and at the same time accord with the established rules of law, such construction must be adopted.

It has long been settled in this commonwealth, that, as to all the world except the mortgagee, a mortgagor is the owner of the mortgaged lands, at least until the mortgagee has entered for possession. *Willington* v. *Gale*, 7 Mass. 138; *Waltham Bank* v. *Waltham*, 10 Met. 334; *White* v. *Whitney*, 3 Met. 81; *Ewer* v. *Hobbs*, 5 Met. 1; *Henry's Case*, 4 Cush. 257; *Howard* v. *Robinson*, 5 Cush. 119; *Buffum* v. *Bowditch Insurance Co.*, 10 Cush. 540; *Farnsworth* v. *Boston*, 126 Mass. 1. This being the law, and the mortgagees not being in possession of the premises, the plaintiffs' assignor might well be described in a policy of insurance as the owner of the property insured; and, inasmuch as his estate was in fee simple, not an estate for life, and not a base, qualified, or conditional fee, it might well be described as the entire and unconditional ownership; and, as he had no joint tenant nor tenant in common, his estate was well described as the sole ownership. As between him and the defendant, the mortgages and the lease were mere incumbrances on his title, not affecting its character as entire, and not changing it from an absolute to a conditional estate or ownership. Even as between him and the mortgagee, the mortgagee's estate was the conditional one, determinable by satisfaction of the condition set out in the mortgage deed. There was no joint tenancy nor tenancy in common of the mortgagor and the mortgagees. All the characteristics of such tenancies are lacking in their relations to the property.

The lease for years created only a chattel interest in the premises, not affecting the ownership of the fee. It was merely an incumbrance. It has been held by the Supreme Court of the United States, in a recent case, that an outstanding lease did not invalidate a policy in which the ownership of the assured was described as entire, uncon-

ditional, and sole. *Insurance Co.* v. *Haven*, 95 U.S. 242. And we do not understand that the ruling in the case at bar was supposed to rest on the existence of the lease.

On consideration, we are all of opinion that, on the peculiar language of the policy sued on, the ruling that the interest of the assured was not sufficiently expressed in the policy, and that the policy was therefore void, was erroneous. The case must therefore stand for trial.

QUESTIONS

1. Action by P on a policy containing a provision that the "policy shall be void if the insured is not the sole and unconditional owner of the property insured." The company pleads a breach of condition and shows that P is only a mortgagor in possession. What decision?
2. The company shows that P is a mortgagor and that the mortgagee is in possession. What decision?
3. The company shows that P is mortgagee and not in possession. What decision?
4. The company shows that the property is held by X under a lease for twenty years. What decision?
5. The company shows that P is only an equitable owner and that T holds the legal title in trust for him. What decision?
6. The standard policy contains this provision: "If mechanics be employed in the building, altering, or repairing the within described premises for more than fifteen days at any one time without the written consent of the company, this policy shall be void." What is the purpose of this provision?
7. P brings an action on a policy containing the provision in the foregoing question. The company proves that P had mechanics engaged in work on the premises, without its permission, for more than fifteen days. P offers to prove that the fire in question occurred more than three weeks after the mechanics had finished their work. Should the evidence be admitted?

GIBB *v.* PHILADELPHIA FIRE INSURANCE COMPANY

59 Minnesota Reports 267 (1894)

CANTY, J. On February 29, 1892, the plaintiff Gibb was the owner in fee simple of the premises in question, subject to a mortgage of $1,200, held by the plaintiff Hilles. On that day defendant issued a policy of insurance insuring Gibb to the amount of $2,000, for three years from and after that day, against loss by fire of the buildings on

the premises, loss, if any, payable to Hilles as her interest may appear; but providing that if, in case of loss, the insurer is not liable to the mortgagor or owner, it shall be subrogated to the rights of the mortgagee under her mortgage, and, upon paying the full amount due on the mortgage, shall receive an assignment of it. This mortgage clause also provided that the policy should not be invalidated as to the mortgagee by any act of the owner, or by any change in the title or ownership of the premises.

On February 28, 1893, there was a loss by fire amounting to $1,462.62. The plaintiffs brought this action to recover this loss. The case was tried by the court without a jury, and judgment was ordered in favor of Hilles, for $1,200, the amount of her mortgage, and in favor of Gibb for the balance of said amount of the loss. From the judgment entered thereon, defendant appeals.

The appellant concedes that the plaintiff Hilles is entitled to recover, but contends that a breach occurred, prior to the fire, which avoided the policy as to Gibb; that he is not entitled to recover; and that defendant is entitled, on payment to Hilles of the amount of her mortgage, to be subrogated to her rights under the mortgage. The policy contains the following provisions: "This entire policy, unless otherwise provided by agreement indorsed hereon or added hereto, shall be void if any change, other than by the death of the insured, takes place in the interest, title, or possession of the subject of insurance (except change of occupants, without increase of hazard), whether by legal process of judgment, or by voluntary act of the insured, or otherwise."

It is found by the court that on March 23, 1892, plaintiff made a contract in writing with one Maggie J. Kelly whereby he sold and agreed to convey to her the premises, consisting of five lots, by deed of warranty, on prompt and full performance by her of the agreement, and she agreed to pay therefor the sum of $2,500—$300 cash, and $1,000 in instalments of $50 every sixty days thereafter until paid, the balance to be paid by her in assuming said mortgage—she to have possession of the premises until default in payment; and in case of such default she agreed to surrender possession on demand, and that the agreement should be void at the option of the vendor; that at and from the time of making the policy of insurance, until the time of making the contract of sale, the buildings had been unoccupied, and that, on the making of said contract of sale, said Kelly entered into the possession of the buildings and premises, and occupied the

same until the time of the fire, and made all her payments during that time, and was not in default in any manner upon said contract.

It is contended by appellant that, by the transactions with Kelly, there took place a change in the interest, title, and possession of Gibb, and the condition against any such change was broken, and the policy avoided as to him. It seems to us that there was a breach in the condition against any change of interest. It is not claimed by plaintiffs that there was any waiver of this condition, and the authorities cited by counsel are nearly all cases where the breach claimed was not of a condition against a change of interest, but a change of title. It is held by the great weight of authority that, where the condition is against any change in the title, there is no breach unless there is a change in the legal title, that as long as the insured retains the legal title and an insurable interest in the premises, the policy is not avoided by a transfer of the equitable title or of equitable interests; but we cannot apply this doctrine to a condition against any change of interest. The terms are not synonymous, as contended by counsel. The word "interest" is broader than the word "title" and includes both legal and equitable rights. It is not necessary to consider the question of the change of possession, except so far as it has an influence on the change of interests by strengthening and fortifying the interest acquired by Kelly. This disposes of the case.

The plaintiff Hilles is entitled to judgment for the sum awarded her, but upon payment of the same the defendant is entitled to be subrogated to her rights under her mortgage, and the defendant is entitled to judgment against the plaintiff Gibb that he take nothing by this action. The judgment appealed from should be reversed, with directions to enter judgment in conformity with this opinion.

QUESTIONS

1. What was the condition under consideration in this case? What was the act alleged to be a breach of the condition?
2. What is the purpose of provisions against changes in title, interest, and possession?
3. Suppose that the condition had been: "When the property shall be alienated by sale or otherwise, the policy shall become void," would the act of the insured in the principal case have been a breach of it?
4. Suppose that the condition had been: "If the property be sold or transferred or any change takes place in the title or possession, this policy shall be void," would the act of the insured have been a breach of it?

5. If the plaintiff in the principal case had mortgaged the insured premises, would the court's conclusion have been the same?
6. D issues a policy of insurance to P, M, and N on a building owned by them as partners. The policy contains a clause, forbidding changes in interest or possession without the consent of the company. N sells his interest in the partnership to his copartners. In an action by the firm on the policy, the company contends that there has been a breach of condition. What decision?
7. In the foregoing case, M assigned his interest to X. Before an accounting had been taken, the building burned. What decision in an action on the policy?
8. P, M, and N take X in as a partner. What decision in an action on the policy?
9. Standard policies usually provide that no action shall be brought on the policy unless commenced within twelve months next after the fire. Is this provision valid? What is the purpose of it? When does the twelve-month period begin to run? May this condition be waived by the insurer?

VIELE *v.* GERMANIA INSURANCE COMPANY

26 Iowa Reports 9 (1868)

Beck, J. The solution of one question will dispose of many points made by defendant relating to the admission and exclusion of evidence, and the giving and refusing of instructions to the jury. The question is this: Can the breach of the conditions of the policy against the increase of the risk, without the written consent of the insurers, whereby the instrument became forfeited, be waived by parol or by the acts of the defendant?

The plaintiff admitted the increase of the risk by the use of a part of the building insured for the manufacture of rustic window shades, but sought to avoid the forfeiture, which otherwise would have resulted, by evidence tending to show the consent of the agent of defendant to such use, his acts and declarations recognizing the contract of insurance, after the increase of the risk, and his admission that the building continued to be covered by the policy. This evidence was given to the jury against the objection of defendant, and the court held, in the instructions to the jury, that such facts, if proved, would operate as a waiver of the forfeiture and entitle plaintiff to recover. The following are among the conditions of the policy: "If the above-mentioned premises shall be used or occupied so as to

increase the risk, or become vacant and unoccupied, or the risk be increased by the erection of adjacent buildings, or by any other means whatever, within the control of the assured, without the assent of the companies indorsed hereon; or if the assured shall keep upon the said premises gunpowder or phosphorus; or petroleum, or rock or earth oils, or benzole, benzine, or naphtha, or any explosive substance, or shall keep or use upon the said premises camphene, spirits, gas, or chemical oils, without written permission on this policy, then, and in every case, this policy shall be void."

The question above stated is fairly presented by the record, and is of very great importance, not only in its relation to this case, but to the business of insurance generally. We have endeavored to give it the careful and patient consideration, aided by the able argument of the counsel for the respective parties, which its importance demands.

The position of the defendant's counsel, which is supported by several authorities, is to the effect that upon breach of the conditions of the policy by the assured, which would defeat recovery thereon, it becomes absolutely void, as it were, dead—and that nothing short of a new creation could impart vitality to it. This doctrine is certainly unsound when applied to other contracts; for, on the contrary, after default in the conditions by one party, the other may waive the forfeiture and treat the instrument as of binding force upon himself. No reasons can be given to except policies of insurance from the operation of this rule. The party in default cannot defeat the contract; the party for whose benefit the conditions are introduced may waive the forfeiture. It follows, therefore, that the instrument is forfeited at the option of the innocent party; and if he waives the forfeiture, the contract stands as if no breach had occurred. In *Williams* v. *Bank of the United States*, 2 Peters 102, the doctrine is announced in these words: "If a party to a contract, who is entitled to the benefit of a condition, upon the performance of which his responsibility is to arise, dispenses with, or by any act of his own prevents, the performance, the opposite party is excused from proving a strict compliance with the condition."

We conclude, therefore, that the forfeiture of the policy on account of the breaches of the conditions thereof, could have been waived by the defendant, and if waived, the policy continued of the same binding force which it originally possessed. This view is sustained by the following authorities: *Keenan* v. *Mo. State Mutual Insurance Co.*, 12 Iowa 126; *Viall* v. *Insurance Co.*, 19 Barb. 440; *Insurance Co.*

v. *Stockbower*, 26 Penn. St. 199; *Buckbee* v. *Life Insurance Co.*, 18 Barb. 541; *Beal* v. *Park Insurance Co.*, 16 Wis. 241; *Wing* v. *Harvey*, 27 Eng. Law & Eq. 140; *Peoria F. & M. Insurance Co.* v. *Hall*, 12 Mich. 202.

We are next led to inquire as to the manner of the waiver of the forfeiture, whether it must be in writing or may be parol, and what acts of the defendant will amount to a waiver.

Parol evidence is not admissible to contradict or alter a written instrument, but this rule does not exclude such evidence when adduced to prove that a written contract is discharged, or that the damages for nonperformance were waived, or that performance of a part of the contract was dispensed with. 1 Greenleaf's *Ev.* sec. 302–4; 2 Phil. *Ev.* (Cowen & Hill's and Edward's Notes) 692 and Note 505; 2 Starkie's *Ev.* 574; *Fleming* v. *Gilbert*, 3 Johns. 528; *Merrill* v. *Ithaca & Oswego Railroad Co.*, 16 Wend. 586.

These exceptions to the rule, or rather the rule admitting parol evidence for these purposes, may not apply to specialties; but a contract of insurance need not be by specialty, or even in writing. It seems to be the better opinion that it may be oral only. Parsons' *Maritime Law*, 19 and notes; *City of Davenport* v. *Peoria Insurance Co.*, 17 Iowa 276; *Commercial Insurance Co.* v. *Union Insurance Co.*, 19 How. 321; *Baptist Church* v. *Brooklyn Insurance Co.*, 19 N.Y. 305. We need not, then, inquire whether a policy executed by an incorporation and attested by its corporate seal is a specialty, for the policy sued on is not sealed by the companies, and is therefore a simple contract and not a specialty. The rule therefore will not in this suit exclude parol evidence for the purposes above mentioned. The cases which we will hereafter cite, in considering what acts may amount to a waiver of conditions or forfeiture on account of breaches of conditions, support this doctrine and will illustrate its application.

It is argued that the condition in the policy, to the effect that an increase in the risk avoids the contract on the part of the underwriters, unless consent thereto be had in writing, implies that such consent can be given in no other way. It will be at once remarked, that this restriction is itself a condition, and is just as capable of being waived or dispensed with as any other condition of the instrument and in the same way. There is nothing in the terms of this condition prohibiting its waiver. But the conditions of the policy became broken by an increase of the risk, without written consent, and there at once happened a forfeiture whereby defendant was

discharged from the contract. Now, as a matter of fact, the waiver was not of the written consent, but of the forfeiture.

What will amount to or have the effect of a waiver of a forfeiture of the policy; or a dispensation of the performance of its conditions? The party for whose benefit a condition is introduced in a contract may determine whether it shall or shall not be enforced, and, as we have seen, may waive or dispense with its performance. It seems reasonable that the same character of evidence will establish a waiver or dispensation of conditions that is sufficient to prove the existence of a contract. An express agreement to that effect will of course be sufficient. Circumstances proving that the party treated the contract as subsisting and not forfeited, a course of dealing consistent only with that hypothesis, and acts and declarations whereby the other party was induced to believe that the condition was dispensed with or forfeiture waived, will be sufficient to preclude the setting up of the breaches of the condition as a defense to the contract of the party bound thereby. Thus the receipt of premium upon a policy after forfeiture is a waiver thereof. *North Berwick Co.* v. *Insurance Co.*, 52 Maine 336; *New York Insurance Co.* v. *National Protective Insurance Co.*, 20 Barb. 468; *Liddle* v. *Market Fire Insurance Co.*, 29 N.Y. 184; *Ames* v. *New York Union Insurance Co.*, 26 *idem* 263; *Bochem* v. *Williamsburgh Insurance Co.*, 35 *idem* 131; *Goit* v. *National Prot. Insurance Co.*, 25 Barb. 189; *Viall* v. *Genesee Mutual Insurance Co.*, 19 *idem* 446; *Frost* v. *Saratoga Mutual Insurance Co.*, 5 Den. 154; *Lycoming Insurance Co.* v. *Stockbower*, 26 Penn. St. 199.

So the taking of an additional risk on the same policy will waive a forfeiture, existing at the time, for breach of condition, *Rathborn* v. *City Insurance Co.*, 31 Conn. 193. The knowledge of the officers of an insurance company taking a risk upon the life of a party, that he intended to go south of a certain degree of latitude, is a dispensation of a condition that the insured should not go beyond that latitude. *Bevin* v. *Connecticut Life Insurance Co.*, 23 Conn. 244. The renewal of a life policy which had expired by nonpayment of premium, in favor of one who at the time was sick, and so known to the officer renewing the policy, is a waiver of conditions against ill health of the assured, which otherwise would have avoided the policy. *Buckbee* v. *United States Insurance & Trust Co.*, 18 Barb. 541. The following cases which illustrate the doctrine under discussion, we have not space to classify or further notice in this connection. *Peoria Insurance Co.* v. *Hall*, 12 Mich. 202; *Sheldon* v. *Atlantic Insurance Co.*, 26 N.Y. 460; *Warner*

v. *Peoria Insurance Co.*, 14 Wis. 318; *N.E.F. & M. Insurance Co.* v. *Schettler*, 38 Ill. 166; *Coursen* v. *Pennsylvania Insurance Co.*, 46 Penn. St. 323; *Ruse* v. *Mutual Benefit Life Insurance Co.*, 26 Barb. 556.

It will be observed that the waiver of the condition or forfeiture under these authorities is not required to be supported by a consideration. In the cases where it is held that the payment of premium upon a policy forfeited for breaches of condition is a waiver of forfeiture, the payment was not made in consideration of the waiver, but for the renewal or continuance of the insurance. The waiver or dispensation is not in the nature of a contract which requires the support of a consideration, but rather of an estoppel, whereby the underwriter is precluded from denying the validity of the contract, on account of acts or admissions either recognizing it as of binding force after the forfeiture, or holding out to the assured that the performance of the condition is dispensed with.

It is not an accurate use of terms to say that the condition of a contract must be supported by a consideration. The contract itself must be, but the condition is a mere incident thereto, and its sufficiency, validity, or force is in no way affected or dependent upon the consideration. It is true the condition may influence the parties in fixing the amount of the consideration, but the law will not, in the absence of fraud, inquire into its sufficiency, nor hold a contract invalid because a full or just value has not been received by the obligor. The case of a policy of insurance illustrates the point. The underwriter is bound thereby to pay the assured the amount of any loss by fire which may happen to his property within a certain time. The consideration of this contract is the premium received by the underwriter. The assured is bound not to permit the risk to be increased; this obligation is the condition of the policy, and with it we can associate no idea of consideration. It may enter into the contemplation of the underwriter when fixing the value of the risk, which may be worth a greater premium without the condition in the policy, but the adequacy of the consideration, as we have remarked, is not a matter of inquiry, and the consideration itself no element of the condition. We conclude, therefore, that, as the condition is not dependent upon, nor supported by, the consideration, it may be waived or dispensed with even by an agreement without consideration.

By the terms of the policy the underwriters reserved the right to cancel it upon the risk being increased, or for any other cause "by paying to the assured the unexpired premium *pro rata*." The point

is made by the plaintiff, that if the risk be increased, of which the underwriters have notice, and the right to cancel is not exercised, this amounts to a waiver of the forfeiture incident to a breach of the condition against increase of risk. The decision of this question is not necessary, as the case is determined without it. But, for myself, I am free to admit the force of the position, in view of the peculiar facts of the case, and that I believe it is supported by sound reason. Without discussing the legal principles upon which it is founded, it will readily be seen to be in harmony with our ideas of fair and honest dealing. The agent had full notice of the increase of the risk, obtained upon an examination of the property, made in discharge of his duty, for the express purpose of determining whether there had been such increase. This notice to the agent bound the companies. *Keenan* v. *Missouri State Mutual Insurance Co.*, 12 Iowa 131. If the agent determined that the risk was increased, his duty to his principals of good faith toward the assured, and every principle of honesty, required him to cancel the policy and advise the assured of the fact. It was bad faith of the darkest hue for the agent, upon determining that the risk was increased, so to act and speak as to induce assured to believe that the policy continued to cover the property. The companies thereby retained the money paid as premiums, which they had not earned, and which their contract required should be repaid to the assured upon canceling the policy, and induced their confiding customer to trust for indemnity, to the extent of many thousand dollars, for loss of his property, upon a contract which they had predetermined was avoided, and upon which, according to their interpretation of the law, he could not recover one cent. Such a course of dealing indicates a reckless and fraudulent spirit of gain, which will hazard the property of others to the value of tens of thousands in order to secure an inconsiderable and paltry sum. On the other hand, if, upon such examination of the property, the agent honestly determined that there was not such increase of risk as required the exercise of his power to cancel in order to protect the interest of his principals, and acted upon that determination, whereby the plaintiff was induced to rely upon the policy as a valid, binding contract, the underwriters ought to be bound by such determination and acts of their agent, and ought not to be permitted to set up, as a breach of the conditions, the very things which the agent decided were not breaches. In such a case, while the agent would be relieved of the charge of dishonesty, it would be successfully

sustained against his principals. In whatever light we may view the facts that the increase of the risk was fully known to the agent, and no steps were taken to cancel the policy in accordance with its terms, they involve bad faith and deceit, whereby one party in order to realize a small sum puts at hazard great interests of another, a course of dealing repulsive to all right notions of justice, and nowhere practiced among honest men.

It is argued by the defendant's counsel, that the waiver of the breach of the condition of the policy, on account of the rustic window-shade manufactory, extended only to the acts in violation of the terms of the policy done before such alleged waiver, and that the condition continued to be daily violated by the continuance of the cause of the increase of risk; and that, as it is not pretended that there was any waiver of the breaches resulting therefrom, the policy is thereby avoided. The error of this argument is apparent. The waiver extended to all breaches resulting from the manufacture of rustic window-shades in the building insured, and the parties in all their intercourse concerning the increase of the risk, and by their acts touching the same, had reference to the continuation of the manufactory, and of course contemplated the waiver of the breaches resulting therefrom, and the dispensation of the conditions of the policy prohibiting it.

The policy expressly prohibited the keeping of benzine upon the premises insured. There was evidence tending to prove that this fluid was necessary in the preparation of the paints and varnishes used in the manufacture of rustic window-shades, and that, at the time of the fire, it was kept for that purpose upon the premises, in tin cans, in quantities not exceeding two gallons. The evidence also tended to prove that the agent gave permission for keeping benzine for the purposes and in the manner and quantities aforesaid. This permission was given, as it is claimed, at the time the alleged consent was given to the continuation of the window-shade manufactory. The court instructed the jury, substantially, that a consent to the occupation of the building for the manufactory implied a consent to the use of such articles as were necessary to be used in the business. This instruction was clearly correct. The consent to the manufacture of the window-shades implied a consent to the use of benzine if it was necessary or comonly used in making those articles; otherwise a direct permission to continue the manufactory would be defeated by the prohibition in the policy.

This permission operated to dispense with the prohibition. In *Citizens' Insurance Co.* v. *McLaughlin*, 6 Am. Law Register, N.S. 374, lately decided in the Supreme Court of Pennsylvania, this doctrine was recognized. In that case the policy covered a patent-leather manufactory, and the keeping of benzine upon the premises was prohibited, and confined to a shed detached therefrom. It was a necessary article in the manufacture of patent-leather, and was ordinarily carried in a bucket, containing three or four gallons, into the building insured. The benzine took fire in the bucket and the building was consumed. The court held that the permission to use the building for a patent-leather manufactory, carried with it the permission to use all articles necessary to the business, and dispensed with the prohibition expressed in the policy. The same rule is announced in the following cases: *Harper* v. *Albany Insurance Co.*, 17 N.Y. 194; *Harper* v. *New York Insurance Co.*; 22 *idem* 441; *Pindar* v. *Kings County Insurance Co.*, 36 *idem* 648.

In the light of the doctrines above announced, we find no error in the rulings of the court upon the admission of evidence and the submission of questions to the jury for special findings. It is not necessary to state the special questions raised, or evidence admitted or excluded. Neither do we find error in the finding or refusal to give instructions asked by the parties. Those given are in harmony with the principles of this opinion; those refused are not. It would answer no useful purpose to refer to them more fully. The verdict, as well as the special findings, are well supported by the evidence. The motions to set them aside were properly overruled.

Affirmed.

QUESTIONS

1. P's policy provides: "If gasoline is used on the insured premises without the consent of the insurer, the policy shall be void." What is the effect on the contract of P's use of gasoline on the premises? Is the user a condition subsequent terminating the insurer's liability? Or is the non-user a condition precedent to the insurer's liability?
2. P effects insurance on property which belongs to X. D, aware of the facts, continues to receive premiums from P until the house is destroyed by fire. P sues on the policy. D contends that the policy is void for want of an insurable interest. P replies that D waived lack of insurable interest. What decision?
3. D insures X's life in favor of W. The policy provides that no recovery can be had on it if the life of the insured is terminated by legal judg-

ment. The company, in writing, promises W to pay the loss, X's execution for murder to the contrary notwithstanding. What decision in any action by P on the policy?

4. P's policy forbids the use of gasoline on the insured premises without the written consent of an officer of the company. P, with the verbal consent of an officer of the company, uses the forbidden article in the insured building. P sues on the policy. D relies on a breach of condition. P replies that the condition was waived by an officer of the company. D contends that there was no waiver for the following reasons: (*a*) that a waiver could only be made in writing; (*b*) that there was no consideration for the promise to waive the condition; (*c*) that the promise of the officer of the company, if construed as a waiver, would violate the parol evidence rule. What decision?
5. This is an action on a policy which contains a clause that the policy shall be void in case gasoline is kept on the insured premises without the consent of the company. When A, a general agent of the company, delivered the policy, he saw that gasoline was then being kept on the insured premises. P sues for a loss under the policy. What decision?
6. Action on a policy which provides that it shall be void unless the premiums are paid promptly each month. The company pleads as a defense that the premiums were not paid promptly each month. P replies that A, a general agent of the company, stated that the premiums might be paid semi-annually. What decision?
7. In the foregoing case, P proves that A, before the execution and delivery of a policy, orally stated that the premiums might be paid semi-annually. What decision?
8. P, with the verbal permission of an agent of the company, increased the risk insured against in violation of a term in the policy. P sues for a loss under the policy. D contends that the policy is at an end because of a breach of condition. P offers evidence to prove that on previous occasions this agent had changed terms in the policy and that these changes had been acquiesced in by the company. Should the evidence be admitted?

IV) Amount of Recovery

COMMONWEALTH INSURANCE COMPANY *v.* SENNETT

37 Pennsylvania Reports 205 (1860)

This was an action of debt, brought in the court below by Pardon Sennett, M. R. Barr, Conrad Brown, and J. J. Finley, partners doing business as Sennett, Barr & Co., against the Commonwealth Insurance Company.

The plaintiffs below were owners of a number of machines called mowers and reapers, which they had manufactured for sale and stored in a warehouse at Erie. These were insured against loss or damage by fire by the defendants below, in a policy in the usual form, in the sum of $3,000. The policy was dated May 25, 1857, and was for the term of six months. On November 25, 1857, the policy was renewed by J. J. Lints, agent of defendants, for a further period of six months. On the night of February 10, 1858, the property insured was totally destroyed by fire.

On the trial, the defendants offered to show, by Matthew Dickson and others, that the kind of machines known as Danforth's reaper and mower, and manufactured by the plaintiffs, and being the same kind of machines insured and destroyed, were of little or no value—were worthless as an agricultural instrument, or for any other purpose—and that they had no value, save as mere wood and old iron, and that the machines were worthless both on account of defects in construction, and in the principle of the machines themselves. To this the plaintiffs objected, but the court said: "We will admit evidence to show that the machines could be manufactured at a less price than the plaintiffs' witnesses say they were made and sold for, or the plaintiffs knew, when making them, that they were worthless in principle, and that they were defective in workmanship, but not that they were defective in principle, as it was patented one." To this ruling the defendants excepted.

The policy provided, among other things, as follows: "And the said company do hereby promise and agree to make good unto the said assured, their executors, administrators, or assigns, all such immediate loss or damage not exceeding the sum hereby insured, as shall happen by fire to the property above specified, the said loss or damage to be estimated according to the true and actual cash value of the said property at the time the same shall happen."

The defendants requested the court to instruct the jury as to the measure of damages, that the jury were not to be confined to the evidence of the cost of manufacturing the machines as given by plaintiffs, but might be governed by the actual cash value, as proved by defendants, without reference to the cost of construction. The court refused so to charge the jury, but instructed them that "the value as estimated in the manufacture of each machine, and before it was tried in the field, would be the standard of valuation." And further, on this point, the court said to the jury: "Admitting that many of the machines did not work when they were put to the trial, and this

because of a defect in the principle upon which they were got up, and not in the mechanism of them, that would not interfere with the plaintiffs' right to recover according to their estimated or actual value when the insurance was made, unless, as before stated, the plaintiffs were aware of the defect. The asking or selling price would not be the standard of value, for the company would have the opinion to replace by similar articles or pay the cash, *but the cost of construction.*"

The jury found in favor of the plaintiffs the sum of $3,262.50, and judgment having been entered thereon, the case was removed into this court by the defendants, who assigned for error the instruction of the court below, as to the measure of damages.

THOMPSON, J. There is nothing in the policy of the law which abridges the right and power of parties to a contract of insurance from stipulating in regard to the mode and manner of estimating or valuing a loss when it shall occur, or as to the time which shall be the period of the valuation of the property destroyed, or such other matters within the scope of a fair transaction as they may see proper. Insurance is a contract of indemnity, and if the parties stipulate for the way in which that indemnity shall be made, on the contingency of liability, it is their right to do so, and the law will carry out their contracts as made, if there be no fraud in them, as in other cases: *Trask* v. *The State Fire & Marine Insurance Co.*, 5 Casey 198; *North Western Insurance Co.* v. *Phoenix Oil and Candle Co.*, 7 Casey 448.

The policy in this case was an open one, as contra-distinguished from a valued policy, and in it the parties have chosen to fix for themselves the standard of valuation, and have stipulated that it should be the "true actual cash value of property," and the time for ascertaining such value, to be the date of its injury or destruction by fire. Now, unless it can be shown that they had not the right so to contract, or have used terms possessing some other than their ordinary meaning and import, this basis for estimating the loss thus established must control and govern. It is the law of the contract established by the parties themselves. Nothing has or can be shown, we think, to countervail their right so to contract in regard to the subject-matter mentioned, or which controls the ordinary meaning of the terms used by them. This has not and cannot be done. The contract is so plain, that interpretation is not needed to arrive at what was meant. The parties meant only what they have plainly said; and it was a plain mistake to disregard the language used, and construe the contract as if no stipulation existed.

The case of *Niblo* v. *The North American Insurance Co.*, 1 Sandford 558, has no possible bearing on the point in question. There the policy contained no stipulation such as we find here, and the court allowed the full of the tenement insured without regard to the extrinsic circumstance that it was to be removed within fifteen days. They held that peradventure the lease of the ground might be renewed, or the insured might sell it to the owner of the ground, or its value might not be impaired by removing it to an adjacent vacant lot. Intrinsically it was not impaired by the circumstance that the ground lease was soon to end. Such had been the doctrine laid down in *Laurent* v. *The Chatham Fire Insurance Co.*, 1 Hall 41. Such cases as these are good enough law where they belong, but furnish no rule where the parties have fixed a law for themselves. These views apply as well to the restricted operation of the testimony received, as to the ruling in answer to the defendants' eleventh point. There was error in both.

The option to replace the machinery, if destroyed, was a reservation for the benefit of the company; they were not bound to adopt it. What it would cost to replace it was, therefore, not to furnish the rule for the damages which the company must pay to make good the loss. If this were to be held, it would be equivalent to enforcing the option as an obligation. It is stated in Angell on *Insurance*, sec. 269, that the insurers have the privilege of making repairs or replacing property if they see fit to do so; but if they elect not to do so, "they are liable only to pay a fair indemnity for the loss." This shows that the estimated cost of a compliance with the option is not to be considered in assessing the amount to be paid on the loss. If it had any weight here, it was wrong.

Nor was the fact that the machines insured were constructed under a patent of any importance. Patented or unpatented, what they are worth at the happening of the fire was, by the agreement of the parties, to be the measure of their value; and this must be ascertained by testimony, as is done in every other case, where the value is not fixed.

Judgment reversed.

QUESTIONS

1. P insures his home for $3,000. It is worth that amount to him but he would not be able to secure more than $1,500 for it in the market. What is the measure of P's recovery in the event of the destruction of the house by fire?

2. P, gratuitous bailee of property belonging to X, insures it in his own name for its full value. The property is destroyed by fire. What decision in any action by P for the whole value?
3. X, owner of a house and lot reasonably worth $10,000, mortgages it to P to secure a debt of $1,500. P insures the house for the amount of the debt. A fire occurs, causing damage to the property to the extent of $2,000. P sues on the policy for $1,500. The company contends that he is not entitled to recover because the mortgaged property is still sufficient as security for the debt. What decision?
4. X contracts to sell a house and lot to P for $5,000. The house is reasonably worth $3,500 and P insures it for that amount. Before he has paid any part of the purchase price, the house is destroyed by fire. What are P's rights under the policy?
5. P is a life tenant of an estate on which there is a house worth $10,000. At the age of seventy years, P insures the house for $8,000. Three days later, P dies. P's personal representative brings an action on the policy for $8,000. What decision?

OSHKOSH GAS LIGHT COMPANY *v.* GERMANIA FIRE INSURANCE COMPANY

71 Wisconsin Reports 454 (1888)

Action by the plaintiffs on an insurance policy issued by the defendant. On the trial, the jury returned a verdict of $220.63. From the judgment rendered thereon the defendant appeals.

CASSODAY, J. Upon the verdict of the jury it must be assumed that the building mentioned was wholly destroyed by the fire. At the time of such destruction it was insured in seven different companies, in the aggregate $2,700, one-fifteenth of which was in the defendant company. The evidence tended to show that the value of the building at the time of the fire was about $1,200. The defendant concedes that, if it is liable, it should pay its proportionate share of the true value of the building, but insists that it is not bound to pay the amount specified in the policy. The contract of insurance was made under a statute which declared that "whenever any policy of insurance shall be written to insure any real property, and the property insured shall be wholly destroyed without criminal fault on the part of the insured or his assigns, the amount of the insurance written in such policy shall be taken conclusively to be the true value of the property when insured, and the true amount of loss and measure of damages when destroyed." (R. S., sec. 1943.) Under this statute it is settled by frequent adjudications that the actual value of such real

estate when insured or destroyed, and the consequent *actual* loss to the insured, is wholly immaterial. *Reilly* v. *Franklin Insurance Co.*, 43 Wis. 449. This is the necessary result of the language of the statute making "the amount of the insurance written in such policy" conclusive between the parties to the contract, not only as to the "true value of the property *when* insured" but also as to the "true amount of loss and measure of damages when destroyed."

The statute must be regarded as a part of the contract of insurance, and the amount written in the policy as liquidated damages agreed upon by the parties conclusively in such contract. The several concurrent policies were each written with the consent of the respective companies. This being so, the aggregate amount of such insurance written in the several policies is the value of such property as stipulated in each contract, and hence, as between the parties, must be regarded as conclusive, not only as to the "true value of the property when insured," but also as to the "true amount of loss and measure of damages when destroyed." This must be so, or the statute would be wholly ineffectual whenever there is more than one policy on the same property. And this is so notwithstanding other clauses in the policies inconsistent therewith. The result is that the exceptions to such portions of the charge as, in effect, directed the jury that in case they found the building to have been wholly destroyed, then the plaintiffs were entitled to recover the full amount written in the policy, must be overruled.

Judgment affirmed.

QUESTIONS

1. What is the purpose of statutes like the one under consideration in the principal case? Are such statutes passed for the benefit of the insured or the insurer?
2. Would the decision have been the same in the principal case if it had appeared that the insured had intentionally overstated the value of the property insured?
3. What constitutes a total destruction within the meaning of a *valued policy?*
4. What is the measure of recovery under a *valued policy* when the loss is partial and not total?
5. P owns a house reasonably worth $10,000. He insures the property for $8,000 in each of three different companies. The house is destroyed by fire. (*a*) May he recover $8,000 from each of the three companies? (*b*) May he recover $8,000 from any one of the three companies or must he proceed against each company for one-third of the amount of the insurance?

e) Insurer's Right of Subrogation

PHOENIX INSURANCE COMPANY *v.* ERIE TRANSPORTATION COMPANY

117 United States Reports 312 (1885)

GRAY, J. When goods are wholly lost, actually or constructively, by perils insured against, the insurer, upon payment of the loss, doubtless becomes subrogated to all the assured's rights of action against third persons who have caused or are responsible for the loss. No express stipulation in the policy of insurance, or abandonment by the assured, is necessary to perfect the title of the insurer. From the very nature of the contract of insurance as a contract of indemnity, the insurer, when he has paid to the assured the amount of the indemnity agreed on between them, is entitled, by way of salvage, to the benefit of anything that may be received, either from the remnants of the goods, or from damages paid by third persons for the same loss. But the insurer stands in no relation of contract or of privity with such persons. In a court of common law, it can only be asserted in his name, and, even in a court of equity or admiralty, it can only be asserted in his right. In any form of remedy, the insurer can take nothing by subrogation but the rights of the assured. That the right of the assured to recover damages against a third person is not incident to the property in the thing insured, but only a personal right of the assured, is clearly shown by the fact that the insurer acquires a beneficial interest in that right of action, in porportion to the sum paid by him, not only in the case of a total loss, but likewise in the case of a partial loss, and when no interest in the property is abandoned or accrues to him.

The right of action against another person, the equitable interest in which passes to the insurer, being only that which the assured has, it follows that if the assured has no such right of action, none passes to the insurer; and that if the assured's right of action is limited or restricted by lawful contract between him and the person sought to be made responsible for the loss, a suit by the insurer, in the right of the assured, is subject to like limitations or restrictions.

For instance, if two ships, owned by the same person, come into collision by the fault of the master and crew of the one ship and to the injury of the other, an underwriter who has insured the injured ship, and received an abandonment from the owner, and paid him the amount of the insurance as and for a total loss, acquires thereby

no right to recover against the other ship, because the assured, the owner of both ships, could not sue himself. *Simpson* v. *Thomson*, 3 A.C. 279.

Upon the same principle, any lawful stipulation between the owner and the carrier of the goods, limiting the risks for which the carrier shall be answerable, or the time of making the claim, or the value to be recovered, applies to any suit brought in the right of the owner, for the benefit of his insurer, against the carrier; as, for instance, if the contract of carriage expressly exempts the carrier from liability for losses by fire; *York Co.* v. *Central Railroad*, 3 Wall. 107; or requires claims against the carrier to be made within three months; *Express Co.* v. *Caldwell*, 21 Wall. 264; or fixes the value for which the carrier shall be responsible; *Hart* v. *Pennsylvania Railroad*, 112 U.S. 331. So the stipulation, not now in controversy, in the bills of lading in the present suit, making the value of the goods at the time and place of shipment the measure of the carrier's liability, would control, although in the absence of such a stipulation the carrier would be liable for the value at the place of destination, as held in *Mobile & Montgomery Railway* v. *Jurey*, 111 U.S. 584.

QUESTIONS

1. What is meant by subrogation? Why is the insurer subrogated to the rights of the insured?
2. Through X's negligence, P's house is destroyed by fire. P recovers the loss from X because of his negligence. After getting satisfaction of his judgment against X, he brings an action against the insurer on this policy. What decision?
3. The insurance company pays P the full amount of the loss. X, with knowledge of this payment, pays P an amount in settlement of the claim against him and receives from P a release from further liability. What are the rights of the insurer under these circumstances?
4. P's house is destroyed by the negligence of X. The insurer pays the loss. P thereupon enters into a contract with X by which he agrees to release X from liability for his negligence. What are the rights of the insurer against X under these circumstances?
5. P delivers goods to a carrier to be shipped from X to Y. In the bill of lading there is a stipulation that the railway company shall be entitled to all insurance on the goods in the event of their loss or destruction. The goods are lost in transit. The insurer settles with P and brings an action against the carrier. What decision?

6. X insured his life for $5,000 in favor of W, his wife. X met his death through the negligence of D. The insurer paid the loss to W and brought an action against D for $5,000. What decision?
7. X insures himself with P against accidents. He is injured through D's negligence. P settles with X. What are P's rights, if any, against D?

CASTELLAIN *v.* PRESTON

Law Reports 11 Queen's Bench Division 380 (1883)

Defendants, being owners of certain buildings, effected insurance on them with the Liverpool and London and Globe Insurance Company. Some months later the defendants contracted to sell the buildings and land on which they stood, to Rayner, a tenant, for £3,100. Later on the buildings were damaged by a fire to the extent of £330 which the insurance company paid to defendants. Afterward Rayner accepted a conveyance to the property and paid the full purchase price. This is an action by plaintiff on behalf of the company for the £330. In a trial before CHITTY, J., judgment was given for the defendants.

COTTON, L. J. In this case the appellant's company insured a house belonging to the defendants, and before there was any loss by fire the defendants sold the house to certain purchasers. Afterward there was a fire, and an agreed sum was paid by the insurance office to the defendants in respect to the loss. The appellant apparently seeks to recover the sum which the office paid to the defendants, and if the plaintiff's claim could be shaped only in this form, I think my opinion would be against him. The plaintiff's claim may be treated in substance in another way, namely, the company seeks to obtain the benefit, either wholly or partly, of the amount paid by them out of the purchase money which the defendants have received since the fire from the purchasers. In my opinion, the plaintiff is right in that contention. I think that the question turns on the consideration of what a policy of insurance against fire is, and on what the right of the plaintiff depends. The policy is really a contract to indemnify the person insured for the loss which he has sustained in consequence of the peril insured against, which has happened, and from that it follows, of course, that as it is only a contract of indemnity, it is only to pay that loss which the assured may have sustained by reason of the fire which has occurred. In order to ascertain what that loss is, everything must be taken into account which is received by and

comes to the hand of the assured, and which diminishes that loss. It is only the amount of the loss, when it is considered as a contract of indemnity, which is to be paid after taking into account and estimating those benefits or sums of money which the assured may have received in the diminution of the loss. If the proposition is stated in that manner it is clear that the office would be entitled to the benefit of anything received by the assured before the time when the policy is paid, and it is established by the case of *Darrell* v. *Tibbitts*, 5 Q.B.D. 560, that the insurance company is entitled to that benefit, whether or not before they pay the money they insist upon that calculation being made of what can be recovered in diminution of the loss by the assured; if they do not insist upon that calculation being made, and if it afterward turns out that in consequence of something which ought to have been taken into account in estimating the loss, a sum of money, or even a benefit not being a sum of money, is received, then the office, notwithstanding the payment made, is entitled to say that the assured is to hold that for its benefit, and although it was not taken into account in ascertaining the sum which was paid, yet when it has been received it must be brought into account, and if it is not a sum of money, but a benefit that has been received, its value must be estimated in money.

Now Lord Blackburn, in the case of *Burnard* v. *Rodocanochi*, 7 App. Cas. 339, states the principle in these words: "The general rule of law (and it is obvious justice) is that where there is a contract of indemnity (it matters not whether it is a marine policy or a policy against fire on land or any other contract of indemnity), and a loss happens, anything which reduces or diminishes the loss comes into the hands of the person to whom he has paid it, it becomes an equity that the person who has already paid the full indemnity is entitled to be recouped by having that amount back." In *Darrell* v. *Tibbitts*, to which I have already referred, the question which we have to consider was whether the insurance office was entitled to the benefit produced in consequence of a covenant to repair if the building should be damaged by an explosion of gas. In my opinion, it was not intended in any way to limit the right of the insurer, as an insurer, to cases where the contract in respect of which benefit had been received related to the same loss or damage as that against which the contract of indemnity was created by the policy. That was what was before this court in that case, and undoubtedly expressions do occur as to a contract relating to the loss or affecting the loss; but the principle was

not limited to contracts. The principle which I have enunciated goes further, and if there is a money or any benefit received which ought to be taken into account in diminishing the loss or in ascertaining what the real loss is against which the contract of indemnity is given, the indemnifier ought to be allowed to take advantage of it in order to calculate what the real loss is, even although the benefit is not a contract or right of suit which arises and has its birth from the accident insured against. Of course, the difficulty is to consider what ought to be taken into account in estimating that loss against which the insurer has agreed to indemnify, and we have been pressed in argument with many difficulties. One which possibly was put to us most strongly, was that the contract of sale has nothing to do with destruction by fire, and if any part of the purchase money is to be taken into account, why is a gift not to be taken into account? That may be said to diminish the loss as well as a contract of sale. The answer is that when a gift is made afterward in order to diminish the loss, it is bestowed in such terms as to show an intention to benefit the assured, and to give the insurer the benefit of that would be to divert the gift from its intended object to a different person. That really was what was decided in *Burnard* v. *Rodocanochi*. There the money bestowed, not as a matter of right, but as a gift, was intended to benefit the assured beyond the amount which they had got in consequence of any insurance. There is another ground which may possibly exclude gifts. It may be that the right of the insurer to have a sum brought into account in diminution of the loss, against which he has given a contract of indemnity, is confined to that which is a right or other incident belonging to the person insured, as an incident of the property at the time when the loss takes place. This definition would not include a sum subsequently bestowed on the assured by way of gift, for it can in no way be said to have been appertaining to him as owner of the property at the time when the loss took place. But, in the present case, what we have to consider is whether the contract of sale is not an incident of the property, belonging to the owners at the time of the loss in such a way that it ought to be brought into account in estimating the loss, against which the insurer has undertaken to indemnify. What was the position of the parties? The defendant's house was insured, and there was a loss from fire, the damage caused by the fire being estimated by the parties at £330. Ultimately, the property having been already agreed to be sold at a fixed price, the assured received the whole amount of that

price. Now they did that in respect of a contract relating to the subject insured, the house; and, to my mind, if they received the whole amount of the price which they previously had fixed as the value of the house, that must of necessity be brought into account when it was received, for the purpose of ascertaining what was the ultimate loss against which they had concluded a contract of indemnity with the insurance office. Here the purchasers have paid the money in full and as the property was valued between the vendors and the purchasers at £3,100, the vendors got that sum in respect of that which had been burned, but which had not been burned at the time when the contract was entered into. They had fixed that to be the value, and then any money which they got from the purchasers, and which together with £330, the sum paid by the office, exceeds the value of the property as fixed by them under the contract to sell, must diminish, and in fact entirely extinguishes the loss occasioned to the vendors of the property by the fire.

Therefore, though it cannot, to my mind, be said that the insurers are entitled, because the purchase is completed, to get back the money which they have paid, yet they are entitled to take into account the money subsequently received under a contract for the sale of the property existing at the time of the loss, in order to see what the ultimate loss was against which they gave their contract of indemnity. On the principle of *Darrell* v. *Tibbitts*, when the benefit afterward accrued by the completion of the purchase, the insurance company were entitled to demand that the money paid by them should be brought into account. Therefore the conclusion at which I have arrived is, that if the purchase money has been paid in full, the insurance office will get back that which they have paid, on the ground that the subsequent payment of the price which had been before agreed upon, and the contract for payment of which was existing at the time, must be brought into account by the assured because it diminishes the loss against which the insurance office merely undertook to indemnify them. In my opinion, therefore, the decision below was erroneous. I think CHITTY, J., based it upon this, that in this case there was no right of subrogation, no contract which the office could have insisted upon enforcing for their benefit. I think it immaterial to decide that question, because the vendors have exercised their right to insist upon the completion of the purchase.

Judgment reversed.

QUESTIONS

1. Why should the insurer have been entitled to the £330? Had it not been fully compensated for carrying the risk?
2. If you are of the opinion that the insurer should not have been decreed the £330, how should the amount be disposed of?
3. Suppose that the father of the defendant had given him £330 to cover the loss, would the insurer have been entitled to this sum?
4. Can this case be reconciled with the case of *Foley* v. *The Insurance Company*, *supra*, p. 30?
5. X mortgaged his house to P to secure a debt of $5,000. P immediately insured the building for that amount to secure the debt. The house burned and P recovered the full loss from the insurer. What are the rights of the insurer against X, the mortgagor?
6. In the foregoing case, P, after having received the $5,000 from the insurer, proceeds against X to foreclose the mortgage and to collect the mortgage debt from him. What decision?

LAW AND LABOR

CHAPTER I

INTRODUCTORY TOPICS

A

Another group of problems which the business man must face arises in connection with the administration and control of his labor. Any person engaged in a business enterprise, in the conduct of which he must rely upon a representative or representatives for the performance of a part of his activities, is, to the extent of such reliance, an employment manager and to the same extent confronted by labor problems. Obviously enough these problems will be more acute and more numerous in some businesses than in others; but the fact remains that in all businesses, in a greater or less degree, labor problems arise and demand solution.

A great many factors of diverse character are involved in the successful administration of labor, factors which, for the most part, lie outside the scope of our present inquiry. The important fact to which the student's attention is called in this connection is that the whole problem of labor administration is shot through and through with legal considerations which the wise business administrator cannot afford to ignore. His policies and practices in administration will to a very large extent be guided, and in many cases, dictated by these legal considerations. It is our purpose here to consider some of the more significant legal aspects of the business administrator's relation to labor and labor employment. The law pertaining to labor is so extensive and complicated that the most we can reasonably hope to do is to open the field and master some of the fundamental principles.

In the first place, it is necessary to consider the relation of employer and employee or, as it is known under the common law, the relation of master and servant. On the one hand, there is the problem of the contract of employment between the employer and the employee; and on the other, there is the problem of the liability of the employer for injuries received by his employee in the course of his employment.

The common law courts entertained a high regard for freedom of contract. They hesitated, except in rare instances, to interfere with any contract entered into by parties of full age and of sound mind. Accordingly, they enforced all contracts of employment, however harshly such contracts might operate on employees, unless assent thereto was secured by unfair means, such as fraud or duress of person. They proceeded upon the assumption, and perhaps in the beginning that assumption was justifiable, that there was economic equality between employer and employee. They refused to recognize that employers had a substantial advantage in bargaining and that they could bring to bear upon employees duress just as real and compelling as duress of person. So in general it may be said that the courts of common law pursued a strict policy of non-interference with employers and employees in the making of their contracts of employment.

Even if the courts had adopted the view that contracts of employment induced by economic duress were against sound public policy, they did not possess adequate means for enforcing such a view. The courts had no administrative machinery for enforcing new standards by constant control and supervision. Nor had they developed the principle that the making of a contract against public policy is punishable as a crime. In fact the common law courts possessed no power to discourage such contracts other than by refusing to enforce them. A policy of non-enforcement of unfair contracts of employment would have been highly ineffective in establishing and maintaining an equal bargaining relation between employer and employee, for even if the courts had permitted the employee to avoid such a contract, the worker's position would not have been materially bettered; he would in all probability have been compelled to accept the same or similar employment under still more harsh terms. If therefore the courts had assumed the power to formulate new standards, based upon the inequality of the bargaining relation between employer and employee, they would not have had adequate means for enforcing them.

In the course of time, with the tremendous growth of our industrial system, with its increasing complexity and with its far-reaching hazards, three things became perfectly clear: that workers were not on an equal bargaining plane with their employers; that new bases for contracts of employment had to be established; and that machinery, more adequate than that available in courts of common law, had to be set up for the enforcement of the new standards.

Legislatures within recent times set about to equalize the bargaining relation between employer and employee and in so doing have to a considerable extent narrowed the freedom of contract which the courts of common law regarded so highly. They have passed laws regulating child labor, woman labor, hours and places of work, wages, and numerous other matters which were formerly regulated almost entirely by agreement of the parties concerned. In other words, they have taken from the employer and employee the power to decide for themselves many questions of common interest and set up standards which the parties cannot ignore in their dealings with each other. Moreover, legislatures have created new agencies, such as labor inspectors, factory inspectors, and industrial boards, to see that these standards are observed and have provided appropriate punishment for those who do not observe them.

"Due process of law" is the obstacle which legislatures most frequently encounter in passing laws regulating the contract of employment. This obstacle is found in the Fourteenth Amendment to the Federal Constitution which provides that no state shall deprive a "person of life, liberty, or property, *without due process of law*"; it is also found in the Fifth Amendment as a limitation upon Congress. Due process of law in this connection means that the liberty or freedom to contract is not to be interfered with by law-making bodies unless there are good reasons for such interference; and not even then, if such interference is unreasonable. It means that all parties concerned are entitled to fair treatment according to the prevailing social and economic sense of the community as interpreted by legislatures and ratified by courts. Due process is therefore accorded by laws regulating the contract of employment, if they are really necessary for the protection of the working class and if they are not unreasonable in view of the object to be accomplished by them.

The principles of the common law with respect to the liability of the master for injuries sustained by the servant in the course of his employment proved to be quite as unsatisfactory in a changing society as the rules with regard to freedom of contract. The common law doctrines of liability originated for the most part at a time when industry was relatively small, when industrial hazards were neither numerous nor serious, and when capital was timid and needed encouragement. It is not surprising therefore that these common law principles should have failed utterly to meet the needs of a modern, large-scale industry. And to the extent that these doctrines of the common law failed, legislatures have been forced to create new bases

of liability, fundamentally different from those which the courts of common law recognized and enforced.

Our next task, therefore, in considering the relation of employer and employee, will be to examine briefly the liability of the master for injuries sustained by the servant in the course of his employment. We shall first consider the doctrines of the common law and see how far and why these doctrines failed to meet the needs of a modern, industrial régime; and in the second place we shall look at some typical legislation which supplants much of the common law and sets up new bases of liability.

The final topic for consideration in the law relating to labor deals with competitive practices in what has been aptly termed the *labor market.* The employer of labor will find himself in competition with rival employers for labor; he will find himself in competition with his employees and prospective employees with respect to terms of employment; and he will find that his business all too frequently is affected by competitive practices between rival organizations of labor struggling for supremacy.

Our concern in this connection is to determine as far as is possible the attitude of the courts in passing upon the legality of these various competitive struggles. It has been said that the

> Underlying right which seems to be coming into general recognition as the subject of protection by courts of equity, through the instrumentality of an injunction, appears to be the right to enjoy a certain free and natural condition of the labor market, which, in a recent case in the House of Lords, was referred to, in the language of Lord ELLENBOROUGH, as a "probable expectancy." This underlying right has otherwise been broadly defined or described as the right which every man has to earn his living, or to pursue his trade or business, without undue interference, and might otherwise be described as the right which every man has, whether employer or employee, of absolute freedom to employ or be employed. The peculiar element of this, perhaps, newly recognized right, is that it is an interest which one man has in the freedom of another. A large part of what is most valuable in modern life seems to depend more or less directly upon "probable expectancies." When they fail, civilization, as at present organized, may go down. As social and industrial life develops and grows more complex these "probable expectancies" are bound to increase. It would seem to be inevitable that courts of law, as our system of jurisprudence is evolved to meet the growing wants of an increasingly complex social order, will discover, define, and protect from undue interference more of these "probable expectancies." It is freedom in the market, freedom

in the purchase and sale of all things, including both goods and labor, that our modern law is endeavoring to insure to every dealer on either side of the market.[1]

Assuming that both employer and employee have an interest in a free labor market, and that each is entitled to legal protection of his "probable expectancies," certain questions naturally arise for consideration. What constitutes undue interference with the freedom of the market? How far may an employer go in securing labor as against a rival employer? How far may an employer go in forcing his conditions of employment upon the employee? How far may the employee go in imposing his terms upon the employer? In answering these questions, the courts have usually approached them in terms of the objects sought and the means used. What is the object sought? Is it legitimate? Is it worthy of legal protection? What are the means used in accomplishing the object? Are they fair and reasonable to all concerned? If the means used are unreasonable and illegal, it is immaterial that the object sought is legitimate. If the object sought is illegal, the practices are illegal regardless of the reasonableness of the means used.

Within recent times the working classes have manifested considerable dissatisfaction with the existing state of the law with respect to the legality of their bargaining practices. They claim that the use of the injunction as a weapon by the employing class is not only unfair but historically inappropriate; that too much power is vested in the courts to declare organizations of labor malicious combinations; that many practices, which ought to be justifiable because they are the natural outgrowth of trade competition, are condemned as illegal because done for a "purpose which a judge" considers "socially and economically harmful"; and that, "due largely to environment, the social and economic ideas of judges," which thus become "translated into law," are "prejudicial to a position of equality between workingman and employer." In concluding the discussion of the law relating to labor some attention must therefore be given to legislation which has resulted from this dissatisfaction and which is "designed to equalize before the law the position of workingman and employer as industrial combatants."[2]

[1] *Jersey City Printing Co.* v. *Cassidy*, 63 N.J. Equity, 759.

[2] See dissenting opinion of JUSTICE BRANDEIS, in the case of the *Duplex Printing Co.* v. *Deering*, 254 United States Reports, 443, 484, 485.

CHAPTER II

THE RELATION OF EMPLOYER AND EMPLOYEE

1. The Contract of Employment

JOHNSTON *v.* FARGO

184 New York Reports 379 (1906)

GRAY, J. The plaintiff, while in the employment of the American Express Company, the defendant, sustained personal injuries, for which he has recovered this judgment in the Municipal Court of the City of Syracuse; which has been affirmed by the County Court of Onondaga County and by the Appellate Division of the Supreme Court, in the fourth department. The latter court was divided in opinion and has permitted the defendant to appeal to this court, upon the ground that there was a question of law in the case, which ought to be reviewed by us. The injuries were occasioned by the plaintiff's falling with an elevator, in the barn of the express company while it was being used for carrying down some vehicles, and the complaint charges that it was in a defective condition and that the occurrence was due to the negligence of the defendant. The evidence upon the trial was such as to raise questions of fact, as to the negligence of the defendant and as to the contributory negligence of the plaintiff, and these questions were properly submitted by the trial court for the determination of the jury. They demand no further consideration by us. The one question for discussion upon this appeal is the sufficiency of the defense made by the company upon an agreement, which the plaintiff, upon entering the defendant's employment, executed and delivered to it. It was in these words:

I do further agree, in consideration of my employment by said American Express Company, that I will assume all risks of accident or injury which I shall meet with or sustain in the course of such employment, whether occasioned by the negligence of said company, or any of its members, officers, agents, or employees, or otherwise; and that, in case I shall at any time suffer any such injury, I will at once execute and deliver to said company a good and sufficient release, under my hand and seal, of all claims, demands, and causes of action, arising out of such injury or connected therewith, or resulting therefrom, and I hereby bind myself, my heirs, executors and

administrators with the payment to said express company, on demand, of any sum which it may be compelled to pay in consequence of any such claim, or in defending the same, including all counsel fees and expenses of litigation connected therewith.

In submitting the case to the jury, the trial judge charged as follows, with respect to this defense: "There is a clause in the contract which provides that the plaintiff shall release the defendant from any injuries which he might suffer by reason of the negligence of the defendant. I shall hold as a matter of law that that clause in that contract is void as being without consideration and as against public policy." At the Appellate Division the judgment was upheld, on this point, upon the ground that the agreement was contrary to public policy, and, therefore, invalid, and JUSTICE HISCOCK, who delivered the opinion of the court, has presented the reasoning in support of that view very fully and ably.

The question is one upon which this court has not pronounced itself, and it is of considerable importance, touching as it does the principle of freedom of contract. In the case of *Purdy* v. *R.W.& O. Railroad Co.* (125 N.Y. 209), such a contract to release the employer from liability for injury through negligence was involved; but it was held to have been void for being without the support of any consideration. It was said that no intimation was intended that it would have been valid, if there had been a consideration for it, and that "it might even then be urged that public policy forbids the exaction of such a contract from its employees by railroad and other corporations and upon that question we desire to express no opinion at the present time." In *Kenney* v. *N.Y.C.& H.R. Railroad Co.* (125 N.Y. 422), the contract for exemption from liability was between the defendant and the plaintiff's employer, an express company, under which the former sought to defeat the plaintiff's action. This question was not passed upon; nor was it in the case of *Dowd* v. *N.Y., O.& W. Railway Co.* (170 N.Y. 459), which involved the proposition of the implied assumption by the employee of the risks incident to the employment.

The question of the validity of such a contract between an employer and a person in his employment, as affected by reasons of public policy, it must be conceded, is a debatable one. In support of the right to make the agreement we have respectable authority in decisions of the courts of England and of the state of Georgia. (*Griffiths* v. *Earl of Dudley*, L.R. 9 Q.B. Div. 357; *Western, etc.*,

Railroad Co. v. *Bishop*, 50 Ga. 465; *Same Co.* v. *Strong*, 52 Ga. 461.) The great weight of authority in decisions of the courts of the various states, however, sustains the view that such an agreement is contrary to public policy. (*L.S.& M.S. Railway Co.* v. *Spangler*, 44 Ohio St. 471; *K.P. Railway Co.* v. *Peavey*, 29 Kan. 169; *Willis* v. *G.T. Railway Co.*, 62 Me. 488; *L.R.& F.S. Railway Co.* v. *Eubanks*, 48 Ark. 466; *R.& D. Railroad Co.* v. *Jones*, 92 Ala. 218; *Maney* v. *C.B.& Q. Railroad Co.*, 49 Ill. App. 105; *M.N., etc., Co.* v. *Eifert*, 15 Ky. L.R. 575; *Blanton* v. *Dold*, 109 Mo. 64; *Johnson* v. *R.& D. Railroad Co.*, 86 Va. 975.) The preponderance of authority adverse to the validity of such contract is such as greatly and properly influences our view of the question. In *Griffiths* v. *Earl of Dudley* (*supra*), where such an agreement was held to be quite consistent with public policy, the view of the English court as expressed by JUSTICE FIELD, was that "The interest of the employed only would be affected," and not that of "all society," and "that workmen, as a rule, were perfectly competent to make reasonable bargains for themselves." It is to be observed, however, with respect to the situation in England, that subsequently, in 1897, an act of Parliament was passed, entitled "The Workingmen's Compensation Act," which, in effect, declares the public policy of the state. By that act, in reality, though not in form, the right of the workingman to contract away his right to recover compensation from his employer is nullified, inasmuch as such a contract is only valid when, as between employer and employed, there exists a general scheme for compensation, which secures to the workingman benefits as great as those he would derive from a proceeding under the Compensation Acts.

Contracts are illegal at common law, as being against public policy, when they are such as to injuriously affect, or subvert the public interests. (1 Story, *Eq. Juris.*, section 260*n; Chesterfield* v. *Janssen*, 2 Vesey Sr. 125, 156.) If it were true that the interest of the employed, only, would be affected by such contracts as the present one, as it was held by the English court, in *Griffiths* v. *Earl of Dudley* (*supra*), it would be difficult to defend, upon sound reasoning, the denial of the right to enter into them; but that is not quite true. The theory of their invalidity is in the importance to the state that there shall be no relaxation of the rule of law, which imposes the duty of care on the part of the employer toward the employed. The state is interested in the conservation of the lives and of the healthful vigor of its citizens, and if employers could contract away their responsi-

bility at common law, it would tend to encourage on their part laxity of conduct in, if not an indifference to, the maintenance of proper and reasonable safeguards to human life and limb. The rule of responsibility at common law is as just as it is strict and the interest of the state in its maintenance must be assumed; for its policy has, in recent years, been evidenced in the progressive enactment of many laws, which regulate the employment of children and the hours of work, and impose strict conditions with reference to the safety and healthfulness of the surroundings of the employed, in the factory and in the shop. The employer and the employed, in theory, deal upon equal terms; but, practically, that is not always the case. The artisan, or workman, may be driven by need, or he may be ignorant, or of improvident character. It is, therefore, for the interest of the community that there should be no encouragement for any relaxation on the employer's part in his duty of reasonable care for the safety of his employees. That freedom of contract may be said to be affected by the denial of the right to make such agreement is met by the answer that the restriction is but a salutary one, which organized society exacts for the surer protection of its members. While it is true that the individual may be the one, who, directly, is interested in the making of such a contract, indirectly the state, being concerned for the welfare of all its members, is interested in the maintenance of the rule of liability and in its enforcement by the courts.

To a certain extent, the internal activities of organized society are subject to the restraining action of the state. This is evidenced by the many laws upon the statute book, in recent years, which have been passed for the purpose of prohibiting, restricting, or regulating the conduct of a private business, either because regarded as hurtful to the health or welfare of the community, or because deemed from its nature, or magnitude, affected with a public interest. It has been observed that it is still the business of the state, in modern times, to defend individuals against one another, and, though the proposition is a broad one, when considered with reference to penal legislation and all legislation intended for the promotion of health, welfare, and safety of the community, it is not without truth. It is evident, from the course of legislation framed for the purpose of affording greater protection to the class of the employed, that the people of this state have compelled the employer to do many things which at common law he was not under obligation to do. Such legislation may be regarded as supplementing the common-law rule of the employer's

responsibility and is illustrative of the policy of the state. Therefore it is, when an agreement is sought to be enforced which suspends the operation of the common-law rule of liability and defeats the spirit of existing laws of the state, because tending to destroy the motive of the employer to be vigilant in the performance of his duty toward his employees, that it is the duty of the court to declare it to be invalid and to refuse its enforcement.

I think that the judgment below was correct and should be affirmed, with costs.

QUESTIONS

1. P sues D, his employer, for damages arising out of D's negligence. In defense, D relies upon a contract entered into after the injury by which P agreed to release him from liability for the injury. What decision?
2. P engages D to work in his mine with the understanding that the latter is to work fourteen hours a day. D is compelled by his economic conditions to accept P's terms although he realizes that such a long working day will be highly detrimental to his health. P sues D for a breach of the contract. D contends that the contract is illegal and void. What decision?
3. D engages P to work as a day laborer in his factory at a compensation which is not sufficient to provide P and his family with the necessaries of life. P sues D for the reasonable value of his services. D sets up the contract of employment as a defense. P contends that the wage contract is illegal and void because he was forced to enter into it by economic pressure. What decision?
4. D discharges P from his employ. P sues D for breach of a contract of employment. D alleges and proves by way of defense that notices were published in his plant that employees were not privileged to join unions; and that P, in violation of these notices, joined a union. What decision?
5. P, after experiencing several costly strikes, resolves "to run his mines non-union." Thereafter all men engaged are required to agree that they will not join a union. D and others, representing a union of miners, determine to unionize P's mines. They proceed "to enroll all employees who are willing to agree that they will join a union if it is organized at P's mines." P asks that D and the others be enjoined from continuing their activities in and about his mines. What decision?

ADAIR *v.* UNITED STATES

208 United States Reports 161 (1908)

The facts, which involve the constitutionality of Section 10 of the act of Congress, concerning carriers engaged in interstate com-

merce (known as the Erdman Act), passed June 1, 1898, c. 370, 30 Stat. 424, are stated in the opinion.

HARLAN, C. J. The tenth section, upon which the present prosecution is based, is in these words:

> That any employer subject to the provisions of this act and any officer, agent, or receiver of such employer, who shall require any employee, or any person seeking employment, as a condition of such employment, to enter into an agreement, either written or verbal, not to become or remain a member of any labor corporation, association, or organization; or shall threaten any employee with loss of employment, or shall unjustly discriminate against any employee because of his membership in such a labor corporation, association, or organization, is hereby declared to be guilty of a misdemeanor, and, upon conviction thereof in any court of the United States of competent jurisdiction in the district in which such offense was committed, shall be punished for each offense by a fine of not less than one hundred dollars and not more than one thousand dollars.

The present indictment was in the District Court of the United States for the Eastern District of Kentucky against the defendant Adair.

The accused Adair demurred to the indictment as insufficient in law, but the demurrer was overruled. After reviewing the authorities, in an elaborate opinion, the court held the tenth section of the act of Congress to be constitutional. 152 Fed. Rep. 737. The defendant pleaded not guilty, and after trial a verdict was returned of guilty on the first count and a judgment rendered that he pay to the United States a fine of $100.

It thus appears that the criminal offense charged in the count of the indictment upon which the defendant was convicted was, in substance and effect, that being an agent of a railroad company engaged in interstate commerce and subject to the provisions of the foregoing act of June 1, 1898, he discharged one Coppage from its service because of his membership in a labor organization, no other ground for such discharge being alleged.

May Congress make it a criminal offense against the United States—as by the tenth section of the act of 1898 it does—for an agent or officer of an interstate carrier, having full authority in the premises from the carrier, to discharge an employee from service simply because of his membership in a labor organization?

The first inquiry is whether the part of the tenth section of the act of 1898 upon which the first count of the indictment was based

is repugnant to the Fifth Amendment of the Constitution declaring that no person shall be deprived of liberty or property without due process of law. In our opinion that section, in the particular mentioned, is an invasion of the personal liberty, as well as of the right of property, guaranteed by that Amendment. Such liberty and right embraces the right to make contracts for the purchase of the labor of others and equally the right to make contracts for the sale of one's own labor; each right, however, being subject to the fundamental condition that no contract, whatever its subject-matter, can be sustained which the law, upon reasonable grounds, forbids as inconsistent with the public interest or as hurtful to the public order or as detrimental to the common good. This court has said that "in every well-ordered society, charged with the duty of conserving the safety of its members, the rights of the individual in respect of his liberty may, at times, under the pressure of great dangers, be subjected to such restraint, to be enforced by reasonable regulations, as the safety of the general public may demand." *Jacobson* v. *Massachusetts*, 197 U.S. 11, 29, and authorities there cited. Without stopping to consider what would have been the rights of the railroad company under the Fifth Amendment, had it been indicted under the act of Congress, it is sufficient in this case to say that as agent of the railroad company and as such responsible for the conduct of the business of one of its departments, it was the defendant Adair's right—and that right inhered in his personal liberty, and was also a right of property—to serve his employer as best he could, so long as he did nothing that was reasonably forbidden by law as injurious to the public interests. It was the right of the defendant to prescribe the terms upon which the services of Coppage would be accepted, and it was the right of Coppage to become or not, as he chose, an employee of the railroad company upon the terms offered to him. Mr. Cooley, in his treatise on *Torts*, page 278, well says:

> It is a part of every man's civil rights that he be left at liberty to refuse business relations with any person whomsoever, whether the refusal rest upon reason, or is the result of whim, caprice, prejudice or malice. With his reasons neither the public nor third persons have any legal concern. It is also his right to have business relations with any one with whom he can make contracts, and if he is wrongfully deprived of this right by others, he is entitled to redress.

In *Lochner* v. *New York*, 198 U.S. 45, 53, 56, which involved the validity of a state enactment prescribing certain maximum hours for

labor in bakeries, and which made it a misdemeanor for an employer to require or permit an employee in such an establishment to work in excess of a given number of hours each day, the court said:

> The general right to make a contract in relation to his business is part of the liberty of the individual protected by the Fourteenth Amendment of the Federal Constitution. *Allgeyer* v. *Louisana*, 165 U.S. 578. Under that provision no state can deprive any person of life, liberty, or property, without due process of law. The right to purchase or to sell labor is part of the liberty protected by this amendment, unless there are circumstances which exclude the right. There are, however, certain powers, existing in the sovereignty of each state in the Union, somewhat vaguely termed police powers, the exact description and limitation of which have not been attempted by the courts. Those powers, broadly stated and without, at present, any attempt at a more specific limitation, relate to the safety, health, morals, and general welfare of the public. Both property and liberty are held on such reasonable conditions as may be imposed by the governing power of the state in the exercise of those powers, and with such conditions the Fourteenth Amendment was not designed to interfere. *Mugler* v. *Kansas*, 123 U.S. 623; *In re Kemmler*, 136 U.S. 436; *Crowley* v. *Christensen*, 137 U.S. 86; *In re Converse*, 137 U.S. 624. In every case that comes before this court, therefore, where legislation of this character is concerned and where the protection of the Federal Constitution is sought, the question necessarily arises: Is this a fair, reasonable, and appropriate exercise of the police power of the state, or is it an unreasonable, unnecessary and arbitrary interference with the right of the individual to his personal liberty or to enter into those contracts in relation to labor which may seem to be appropriate or necessary for the support of himself and his family? Of course the liberty of contract relating to labor includes both parties to it. The one has as much right to purchase, as the other to sell, labor.

Although there was a difference of opinion in that case among the members of the court as to certain propositions, there was no disagreement as to the general proposition that there is a liberty of contract which cannot be unreasonably interfered with by legislation. The minority were of opinion that the business referred to in the New York statute was such as to require regulation, and that as the statute was not shown plainly and palpably to have imposed an unreasonable restraint upon freedom of contract, it should be regarded by the courts as a valid exercise of the state's power to care for the health and safety of its people.

While, as already suggested, the rights of liberty and property guaranteed by the Constitution against deprivation without due pro-

cess of law are subject to such reasonable restraints as the common good or the general welfare may require, it is not within the functions of government—at least in the absence of contract between the parties—to compel any person in the course of his business and against his will to accept or retain the personal services of another, or to compel any person, against his will, to perform personal services for another. The right of a person to sell his labor upon such terms as he deems proper is, in its essence, the same as the right of the purchaser of labor to prescribe the conditions upon which he will accept such labor from the person offering to sell it. So the right of the employee to quit the service of the employer, for whatever reason, is the same as the right of the employer, for whatever reason, to dispense with the services of such employee. It was the legal right of the defendant Adair—however unwise such a course might have been—to discharge Coppage because of his being a member of a labor organization, as it was the legal right of Coppage, if he saw fit to do so—however unwise such a course on his part might have been—to quit the service in which he was engaged, because the defendant employed some persons who were not members of a labor organization. In all such particulars the employer and the employee have equality of right, and any legislation that disturbs that equality is an arbitrary interference with the liberty of contract which no government can legally justify in a free land. These views find support in adjudged cases, some of which are cited in the margin. Of course, if the parties by contract fix the period of service, and prescribe the conditions upon which the contract may be terminated, such contract would control the rights of the parties as between themselves, and for any violation of those provisions the party wronged would have his appropriate civil action. And it may be—but upon that point we express no opinion—that in the case of a labor contract between an employer engaged in interstate commerce and his employee, Congress could make it a crime for either party without sufficient or just excuse or notice to disregard the terms of such contract or to refuse to perform it. In the absence, however, of a valid contract between the parties controlling their conduct toward each other and fixing a period of service, it cannot be, we repeat, that an employer is under any legal obligation, against his will, to retain an employee in his personal service any more than an employee can be compelled, against his will, to remain in the personal service of another. So far as this record disclosed the facts the defendant, who seemed to have authority in the premises, did not agree to keep Coppage in service

for any particular time, nor did Coppage agree to remain in such service a moment longer than he chose. The latter was at liberty to quit the service without assigning any reason for his leaving. And the defendant was at liberty, in his discretion, to discharge Coppage from service without giving any reason for so going.

As the relations and the conduct of the parties toward each other was not controlled by any contract other than a general agreement on one side to accept the services of the employee and a general agreement on the other side to render services to the employer—no term being fixed for the continuance of the employment—Congress could not, consistently with the Fifth Amendment, make it a crime against the United States to discharge the employee because of his being a member of a labor organization.

The judgment must be reversed, with directions to set aside the verdict and judgment of conviction, sustain the demurrer to the indictment, and dismiss the case.

QUESTIONS

1. What were the provisions of the law in controversy in the principal case? What objections were urged against the validity of the law? How were these objections disposed of?
2. Kansas passes a law making it a punishable offense for an employer to require an employee to surrender his privilege of joining a union as a condition of employment. D is indicted under the statute. He contends that the law is unconstitutional. What decision?
3. A state passes a law making it a punishable offense for an employer to require an employee, as a condition of employment, to contract to release the employer from liability for negligence. D is being tried for a violation of this law. D contends that the law is unconstitutional because it is in conflict with the Fourteenth Amendment to the Federal Constitution. What decision?

HOLDEN *v.* HARDY

169 United States Reports 366 (1897)

BROWN, J. This involves the constitutionality of an act of the legislature of Utah, of March 30, 1896, c. 72, entitled "An act regulating the hours of employment in underground mines and in smelters and ore reduction works." Session Laws of Utah, 1896, p. 219. The following are the material provisions:

SECTION 1. The period of employment of workingmen in all underground mines or workings shall be eight hours per day, except in cases of emergency where life or property is in imminent danger.

SEC. 2. The period of employment of workingmen in smelters and all other institutions for the reduction of refining of ores or metals shall be eight hours per day, except in cases of emergency where life or property is in imminent danger.

SEC. 3. Any person, body corporate, agent, manager, or employer, who shall violate any of the provisions of sections one and two of this act, shall be guilty of a misdemeanor.

The Supreme Court of Utah was of opinion that if authority in the legislature were needed for the enactment of the statute in question, it was found in that part of Article 16 of the constitution of the state, which declared that "the legislature shall pass laws to provide for the health and safety of employees in factories, smelters, and mines."

The validity of the statute in question is, however, challenged upon the ground of an alleged violation of the Fourteenth Amendment to the Constitution of the United States, in that it abridges the privileges or immunities of citizens of the United States, deprives both the employer and the laborer of his property without due process of law, and denies to them the equal protection of the laws. As the three questions of abridging their immunities, depriving them of their property, and denying them the protection of the laws, are so connected that the authorities upon each are, to a greater or less extent, pertinent to the others, they may properly be considered together.

While the business of mining coal and manufacturing iron began in Pennsylvania as early as 1716, and in Virginia, North Carolina, and Massachusetts even earlier than this, both mining and manufacturing were carried on in such a limited way and by such primitive methods that no special laws were considered necessary, prior to the adoption of the Constitution, for the protection of the operatives; but, in the vast proportions which these industries have since assumed, it has been found that they can no longer be carried on with due regard to the safety and health of those engaged in them without special protection against the dangers necessarily incident to these employments. In consequence of this, laws have been enacted in most of the states designed to meet these exigencies and to secure the safety of persons peculiarly exposed to these dangers. Within this general category are ordinances providing for fire escapes for hotels, theaters, factories, and other large buildings, a municipal inspection of boilers and appliances designed to secure passengers upon railways and steamboats against the dangers necessarily incident to these methods of transportation. In states where manufacturing is carried on to a

large extent, provision is made for the protection of dangerous machinery against accidental contact, for the cleanliness and ventilation of working-rooms, for the guarding of well holes, stairways, elevator shafts, and for the employment of sanitary appliances. In others, where mining is the principal industry, special provision is made for the shoring up of dangerous walls, for ventilation shafts, bore holes, escapement shafts, means of signaling the surface, for the supply of fresh air and the elimination, as far as possible, of dangerous gases, for safe means of hoisting and lowering cages, for a limitation upon the number of persons permitted to enter a cage, that cages shall be covered, and that there shall be fences and gates around the top of shafts, besides other similar precautions.

These statutes have been repeatedly enforced by the courts of the several states, their validity assumed, and, so far as we are informed, they have been uniformly held to be constitutional.

But if it be within the power of a legislature to adopt such means for the protection of the lives of its citizens, it is difficult to see why precautions may not also be adopted for the protection of their health and morals. It is as much for the interest of the state that the public health should be preserved as that life should be made secure. With this end in view quarantine laws have been enacted in most if not all of the states; insane asylums, public hospitals, and institutions for the care and education of the blind established, and special measures taken for the exclusion of infected cattle, rags, and decayed fruit. In other states laws have been enacted limiting the hours during which women and children shall be employed in factories; and while their constitutionality, at least as applied to women, has been doubted in some of the states, they have been generally upheld. Thus, in the case of *Commonwealth* v. *Hamilton Manufacturing Co.*, 120 Mass. 383, it was held that a statute prohibiting the employment of all persons under the age of eighteen, and of all women laboring in any manufacturing establishment more than sixty hours per week, violates no contract of the Commonwealth implied in the granting of a charter to a manufacturing company nor any right reserved under the Constitution to any individual citizen, and may be maintained as a health or police regulation.

Upon the principles above stated, we think the act in question may be sustained as a valid exercise of the police power of the state. The enactment does not profess to limit the hours of all workmen, but merely those who are employed in underground mines, or in the smelting, reduction, or refining of ores and metals. These employ-

ments, when too long pursued, the legislature has judged to be detrimental to the health of the employees, and, so long as there are reasonable grounds for believing that this is so, its decision upon this subject cannot be reviewed by the federal courts.

While the general experience of mankind may justify us in believing that men may engage in ordinary employments more than eight hours per day without injury to their health, it does not follow that labor for the same length of time is innoxious when carried on beneath the surface of the earth, where the operative is deprived of fresh air and sunlight, and is frequently subjected to foul atmosphere and a very high temperature, or to the influence of noxious gases, generated by the processes of refining or smelting.

The legislature has also recognized the fact, which the experience of legislators in many states has corroborated, that the proprietors of these establishments and their operatives do not stand upon an equality, and that their interests are, to a certain extent, conflicting. The former naturally desire to obtain as much labor as possible from their employees, while the latter are often induced by the fear of discharge to conform to regulations which their judgment, fairly exercised, would pronounce to be detrimental to their health or strength. In other words, the proprietors lay down the rules and the laborers are practically constrained to obey them. In such cases, self-interest is often an unsafe guide, and the legislature may properly interpose its authority.

It may not be improper to suggest in this connection that although the prosecution in this case was against the employer of labor, who apparently under the statute is the only one liable, his defense is not so much that his right to contract has been infringed upon, but that the act works a peculiar hardship to his employees, whose right to labor as long as they please is alleged to be thereby violated. The argument would certainly come with better grace and greater cogency from the latter class. But the fact that both parties are of full age and competent to contract does not necessarily deprive the state of the power to interfere where the parties do not stand upon an equality, or where the public health demands that one party to the contract shall be protected against himself. "The state still retains an interest in his welfare, however reckless he may be. The whole is no greater than the sum of all the parts, and when the individual health, safety, and welfare are sacrificed or neglected, the state must suffer."

We have no disposition to criticize the many authorities which hold that state statutes restricting the hours of labor are unconstitutional. Indeed, we are not called upon to express an opinion upon this subject. It is sufficient to say of them, that they have no application to cases where the legislature had adjudged that a limitation is necessary for the preservation of the health of employees, and there are reasonable grounds for believing that such determination is supported by the facts. The question in each case is whether the legislature has adopted the statute in exercise of a reasonable discretion, or whether its action be a mere excuse for an unjust discrimination, or the oppression, or spoliation of a particular class.

We are of opinion that the act in question was a valid exercise of the police power of the state, and the judgments of the Supreme Court of Utah are, therefore,

Affirmed.

QUESTIONS

1. D is being tried for violation of a statute which forbids the employment of children under the age of fourteen years in mills and factories. D contends that the law is unconstitutional because it interferes with his privilege of entering freely into contracts of employment. What decision?
2. In the foregoing case, D contends that the law is unconstitutional for the further reason that it denies him the equal protection of the law, guaranteed by the Federal Constitution, in that the law is made applicable to mills and factories only and not to other occupations. What decision?
3. D is being tried for violation of a statute which provides that "no female shall be employed in any factory or workshop more than eight hours in one day, or forty-eight hours in any one week." D contends that the law is unconstitutional. What decision?
4. D is being tried for violation of a statute which provides that no man shall be employed in underground mines for more than eight hours a day. D contends that the law is unconstitutional, (*a*) because it interferes with his freedom of contract and (*b*) because it denies him the equal protection of the law. What decision?
5. A state passes a law compelling all employers to pay their employees at least twice a month. What is the purpose of this law? Discuss its constitutionality.
6. A state passes a law compelling all employers to pay their employees in cash. What is the purpose of this law? Discuss its constitutionality.

2. Liability of Employer for Injuries to Employees

a) Under the Common Law

i. RISKS ASSUMED BY THE EMPLOYEE

GIBSON *v.* ERIE RAILWAY COMPANY

63 New York Reports 449 (1875)

ALLEN, J. When the deceased entered the employment of the defendant he assumed the usual risks and perils of the service, and also the risks and perils incident to the use of the machinery and property of the defendant as it then was, so far as such risks were apparent. Accepting service with a knowledge of the character and position of the structure from which the employees might be liable to receive injury, he could not call upon the defendant to make alterations to secure greater safety, or in case of injury from risks which were apparent, he could not call upon his employer for indemnity. LORD CHIEF JUSTICE COCKBURN, in *Clarke* v. *Holmes* (7 H. & N. 937), says:

> No doubt, when a servant enters on an employment, from its nature necessarily hazardous, he accepts the service subject to the risks incidental to it; or if he thinks proper to accept an employment on machinery, defective from its construction or from the want of proper repair, and with knowledge of the facts enters on the service, the master cannot be held liable for injury to the servant within the scope of the danger which both the contracting parties contemplated as incidental to the employment.

It is said by ELLSWORTH, J., in *Hayden* v. *Smithville Manufacturing Co.* (29 Conn. 548), that

> Every manufacturer has the right to choose the machinery to be used in his business in the manner most agreeable to himself, provided he does not thereby violate the law of the land. He may select his appliances and run his mill with old or new machinery, just as he may ride in an old or new carriage, or navigate an old or a new vessel. The employee, having knowledge of the circumstances and entering service for the stipulated reward, cannot complain of the peculiar tastes and habits of his employer, nor sue him for damages sustained in and resulting from that peculiar service.

QUESTIONS

1. Assuming that in general a person is not liable for non-negligent injuries which he causes, is there any reason why an exception to this rule should be made in favor of employees or servants injured in the course of their employment?

2. In the running of X industry, a certain number of accidents are inevitable. Is there any reason why these risks should be carried entirely by the employees of that industry? Is there any reason for placing them all on employers in that industry?
3. Even if judgments are given against employers, does it follow that the losses are being carried wholly by employers?
4. One writer, in justification of the rule laid down by the principal case, says: "Under the law of life as well as under the law of the land, a loss must rest upon him on whom it falls unless there is some good reason and opportunity to shift it to someone else. Under the law of justice, and, notwithstanding some notable exceptions, under the common law, a person cannot be held liable for an injury for which he is in no sense at fault. With reference to the risks here concerned, they inhere in the business and are not attributable to the negligence of the master." Is this a sufficient justification for the rule laid down by the principal case?

FARWELL *v.* BOSTON & WORCESTER RAILROAD CORPORATION

4 Metcalf's Massachusetts Reports 49 (1842)

The case was submitted to the court on the following facts agreed by the parties:

The plaintiff was employed by the defendants, in 1835, as an engineer, and went at first with the merchandise cars, and afterward with the passenger cars, and so continued till October 30, 1837, at the wages of two dollars per day; that being the usual wages paid to enginemen, which are higher than the wages paid to a machinist, in which capacity the plaintiff formerly was employed.

On the 30th of October, 1837, the plaintiff, then being in the employment of the defendants, as such engineman, and running the passenger train, ran his engine off a switch on the road, which had been left in a wrong condition (as alleged by the plaintiff, and, for the purposes of this trial, admitted by the defendants) by one Whitcomb, another servant of the defendants, who had been long in their employment as a switchman or tender, and had the care of switches on the road, and was a careful and trustworthy servant in his general character, and as such servant was well known to the plaintiff. By which running off, the plaintiff sustained the injury complained of in his declaration.

The said Farwell (the plaintiff) and Whitcomb were both appointed by the superintendent of the road, who was in the habit of passing over the same very frequently in the cars, and often rode on the engine.

If the court shall be of opinion that, as matter of law, the defendants are not liable to the plaintiff, he being a servant of the corporation, and in their

employment, for the injury he may have received from the negligence of said Whitcomb, another servant of the corporation, and in their employment, then the plaintiff shall become nonsuit; but if the court shall be of opinion as a matter of law, that the defendants may be liable in this case, then the case shall be submitted to a jury upon the facts which may be proved in the case; the defendants alleging negligence on the part of the plaintiff.

SHAW, C. J. This is an action of new impression in our courts, and involves a principle of great importance. It presents a case where two persons are in the service and employment of one company, whose business it is to construct and maintain a railroad and to employ their train of cars to carry persons and merchandise for hire. They are appointed and employed by the same company to perform separate duties and services, all tending to the accomplishment of one and the same purpose—that of the safe and rapid transmission of the trains; and they are paid for their respective services according to the nature of their respective duties, and the labor and skill required for their proper performance. The question is, whether, for damages sustained by one of the persons so employed, by means of the carelessness and negligence of another, the party injured has a remedy against the common employer. It is an argument against such an action, though certainly not a decisive one, that no such action has before been maintained.

It is laid down by Blackstone, that if a servant, by his negligence, does any damage to a stranger, the master shall be answerable for his neglect. But the damage must be done while he is actually employed in the master's service, otherwise, the servant shall answer for his own misbehavior. 1 Bl. Com. 431; *McManus* v. *Crickett*, 1 East, 106. This rule is obviously founded on the great principle of social duty, that every man, in the management of his own affairs, whether by himself or by his agents or servants, shall so conduct them as not to injure another; and if he does not, and another thereby sustains damage, he shall answer for it. If done by a servant, in the course of his employment, and acting within the scope of his authority, it is considered, in contemplation of law, so far the act of the master that the latter shall be answerable *civilater*. But this presupposes that the parties stand to each other in the relation of strangers, between whom there is no privity, and the action, in such case, is an action sounding in tort. The form is trespass on the case, for the consequential damage. The maxim *respondeat superior* is adopted in that case, from general considerations of policy and security.

But this does not apply to the case of a servant bringing his action against his own employer to recover damages for an injury arising in the course of that employment, where all such risks and perils as the employer and the servant respectively intend to assume and bear may be regulated by the express or implied contract between them, and which, in contemplation of law, must be presumed to be thus regulated.

The same view seems to have been taken by the learned counsel for the plaintiff in the argument; and it was conceded that the claim could not be placed on the principle indicated by the maxim *respondeat superior*, which binds the master to indemnify a stranger for the damage caused by the careless, negligent, or unskilful act of his servant in the conduct of his affairs. The claim, therefore, is placed, and must be maintained, if maintained at all, on the ground of contract. As there is no express contract between the parties applicable to this point, it is placed on the footing of an implied contract of indemnity, arising out of the relation of master and servant. It would be an implied promise, arising from the duty of the master to be responsible to each person employed by him, in the conduct of every branch of business, where two or more persons are employed, to pay for all damages occasioned by the negligence of every other person employed in the same service. If such a duty were established by law—like that of a common carrier, to stand to all losses of goods not caused by the act of God or of a public enemy—or that of an innkeeper, to be responsible, in like manner, for the baggage of his guests, it would be a rule of frequent and familiar occurrence, and its existence and application, with all its qualifications and restrictions, would be settled by judicial precedents. But we are of opinion that no such rule has been established, and the authorities, as far as they go, are opposed to the principle. *Priestley* v. *Fowler*, 3 Mees. & Welsby 1; *Murray* v. *South Carolina Railroad Co.*, 1 McMullan (S.C.) 385.

The general rule resulting from considerations as well of justice as of policy is, that he who engages in the employment of another for the performance of specified duties and services, for compensation, takes upon himself the natural and ordinary risks and perils incident to the performance of such services, and in legal presumption, the compensation is adjusted accordingly. And we are not aware of any principle which should except the perils arising from the carelessness and negligence of those who are in the same employment. These are perils which the servant is likely to know, and against which he can as effectually guard as the master. They are perils incident to

the service, and which can be as distinctly foreseen and provided for in the rate of compensation as any others. To say that the master shall be responsible because the damage is caused by his agents, is assuming the very point which remains to be proved. They are his agents to some extent, and for some purposes; but whether he is responsible, in a particular case, for their negligence, is not decided by the single fact that they are, for some purposes, his agents.

If we look from considerations of justice to those of policy, they will strongly lead to the same conclusion. In considering the rights and obligations arising out of particular relations, it is competent for courts of justice to regard considerations of policy and general convenience, and to draw from them such rules as will, in their practical application, best promote the safety and security of all parties concerned. This is, in truth, the basis on which implied promises are raised, being duties legally inferred from a consideration of what is best adapted to promote the benefit of all persons concerned, under given circumstances. To take the well-known and familiar cases already cited: a common carrier, without regard to actual fault or neglect in himself or his servants, is made liable for all losses of goods confided to him for carriage except those caused by the act of God or of a public enemy, because he can best guard them against all minor dangers, and because, in case of actual loss, it would be extremely difficult for the owner to adduce proof of embezzlement, or other actual fault or neglect on the part of the carrier, although it may have been the real cause of the loss. The risk is therefore thrown upon the carrier and he receives, in the form of payment for the carriage, a premium for the risk which he thus assumes. So of an innkeeper: he can best secure the attendance of honest and faithful servants, and guard his house against thieves. Whereas, if he were responsible only upon proof of actual negligence, he might connive at the presence of dishonest inmates and retainers, and even participate in the embezzlement of the property of the guests during the hours of their necessary sleep, and yet it would be difficult and often impossible to prove these facts.

The liability of passenger-carriers is founded on similar considerations. They are held to the strictest responsibility for care, vigilance, and skill on the part of themselves and all persons employed by them, and they are paid accordingly. The rule is founded on the expediency of throwing the risk upon those who can best guard against it. Story on *Bailments*, section 590 ff.

We are of opinion that these considerations apply strongly to the case in question. Where several persons are employed in the conduct of one common enterprise or undertaking, and the safety of each depends much on the care and skill with which each other shall perform his appropriate duty, each is an observer of the conduct of the others, can give notice of any misconduct, incapacity, or neglect of duty, and leave the service, if the common employer will not take such precautions and employ such agents, as the safety of the whole party may require. By these means, the safety of each will be much more effectually secured than could be done by a resort to the common employer for indemnity in case of loss by the negligence of each other. Regarding it in this light, it is the ordinary case of one sustaining an injury in the course of his own employment, in which he must bear the loss himself, or seek his remedy, if he have any, against the actual wrongdoer.

In applying these principles to the present case, it appears that the plaintiff was employed by the defendants as an engineer, at the rate of wages usually paid in that employment, being a higher rate than the plaintiff had before received as machinist. It was a voluntary undertaking on his part, with a full knowledge of the risks incident to the employment; and the loss was sustained by means of an ordinary casualty, caused by the negligence of another servant of the company. Under these circumstances, the loss must be deemed to be the result of a pure accident, like those to which all men, in all employments, and at all times, are more or less exposed; and like similar losses from accidental causes, it must rest where it first fell, unless the plaintiff has a remedy against the person actually in default; on which we give no opinion.

It was strongly pressed in the argument, that although this might be so, where two or more servants are employed in the same department of duty, where each can exert some influence over the conduct of the other, and thus to some extent provide for his own security, yet that it could not apply where two or more are employed in different departments of duty, at a distance from each other, and where one can in no degree control or influence the conduct of another. But we think this is founded upon a supposed distinction on which it would be extremely difficult to establish a practical rule. When the object to be accomplished is one and the same, when the employers are the same, and the several persons employed derive their authority and their compensation from the same source, it would be extremely

difficult to distinguish what constitutes one department and what a distinct department of duty. It would vary with the circumstances of every case. If it were made to depend upon the nearness or distance of the persons from each other, the question would immediately arise, how near or how distant must they be to be in the same or different departments. In a blacksmith's shop persons working in the same building, at different fires, may be quite independent of each other, though only a few feet distant. In a ropewalk, several may be at work on the same piece of cordage, at the same time, at many hundred feet distant from each other, and beyond the reach of sight and voice, and yet acting together.

Besides, it appears to us, that the argument rests upon an assumed principle of responsibility which does not exist. The master, in the case supposed, is not exempt from liability because the servant has better means of providing for his safety, when he is employed in immediate connection with those from whose negligence he might suffer, but because the *implied contract* of the master does not extend to indemnify the servant against the negligence of anyone but himself, and he is not liable in tort, as for the negligence of his servant, because the person suffering does not stand toward him in the relation of a stranger, but is one whose rights are regulated by contract expressed or implied. The exemption of the master, therefore, from liability for the negligence of a fellow-servant does not depend exclusively upon the consideration that the servant has better means to provide for his own safety, but upon other grounds. Hence the separation of the employment into different departments cannot create that liability when it does not arise from expressed or implied contract, or from a responsibility created by law to third persons, and strangers, for the negligence of a servant.

A case may be put for the purpose of illustrating this distinction. Suppose the road had been owned by one set of proprietors whose duty it was to keep it in repair and have it at all times ready and in fit condition for the running of engines and cars, taking a toll, and that the engines and cars were owned by another set of proprietors, paying toll to the proprietors of the road, and receiving compensation from passengers for their carriage; and suppose the engineer to suffer a loss from the negligence of the switch-tender. We are inclined to the opinion that the engineer might have a remedy against the railroad corporation; and if so, it must be on the ground that as between the engineer employed by the proprietors of the engine and

cars and the switch-tender employed by the corporation, the engineer would be a stranger, between whom and the corporation there could be no privity of contract; and not because the engineer would have no means of controlling the conduct of the switch-tender. The responsibility which one is under for the negligence of his servant, in the conduct of his business, toward third persons, is founded on another and distinct principle from that of implied contract, and stands on its own reasons of policy. The same reasons of policy, we think, limit this responsibility to the case of strangers, for whose security alone it is established. Like considerations of policy and general expediency forbid the extension of the principle, so far as to warrant a servant in maintaining an action against his employer for an indemnity which we think was not contemplated in the nature and terms of the employment, and which, if established, would not conduce to the general good.

In coming to the conclusion that the plaintiff, in the present case, is not entitled to recover, considering it as in some measure a nice question, we would add a caution against any hasty conclusion as to the application of this rule to a case not fully within the same principle. It may be varied and modified by circumstances not appearing in the present case, in which it appears that no wilful, wrong, or actual negligence was imputed to the corporation, and where suitable means were furnished and suitable persons employed to accomplish the object in view. We are far from intending to say that there are no implied warran ies and undertakings arising out of the relation of master and servant. Whether, for instance, the employer would be responsible to an engineer for a loss arising from a defective or ill-constructed steam engine; whether this would depend upon an implied warranty of its goodness and sufficiency, or upon the fact of wilful misconduct, or gross negligence on the part of the employer, if a natural person, or of the superintendent or immediate representative and managing agent, in case of an incorporated company—are questions on which we give no opinion. In the present case the claim of the plaintiff is not put on the ground that the defendants did not furnish a sufficient engine, a proper railroad track, a well-constructed switch, and a person of suitable skill and experience to attend it; the gravamen of the complaint is, that that person was chargeable with negligence in not changing the switch, in the particular instance, by means of which the accident occurred, by which the plaintiff sustained a severe loss. It ought, perhaps, to be stated, in justice to the person

to whom this negligence is imputed, that the fact is strenously denied by the defendants, and has not been tried by the jury. By consent of the parties, this fact was assumed without trial, in order to take the opinion of the whole court upon the question of law, whether, if such was the fact, the defendants, under the circumstances were liable. Upon this question, supposing the accident to have occurred, and the loss to have been caused, by the negligence of the person employed to attend to and change the switch, in his not doing so in the particular case, the court is of opinion that it is a loss for which the defendants are not liable, and that the action cannot be maintained.

Plaintiff nonsuit.

QUESTIONS

1. X, a servant of D, while acting in the course of his employment, negligently injures P. P brings an action against D for damages. What decision?
2. The court says that under the doctrine of this case the safety of each servant "will be much more effectually secured than could be done by a resort to the common employer for indemnity in case of loss by the negligence of the other." Is this statement convincing?
3. The court says that the servant "takes upon himself the natural and ordinary risks and perils incident to the performance of such services and in legal presumption the compensation is adjusted accordingly." To what extent is this true?
4. The court says that when a servant enters the master's employ he impliedly contracts that he will assume the risk of injury due to the negligence of his fellow-servants. Do you suppose that a servant actually intends to assume such risks or is this statement simply a fiction of the law?
5. When was the fellow-servant rule first announced? What was the size of industry at the time? What were the characteristics of industry at the time?
6. Even if a servant should recover a judgment from his master because of the negligent conduct of a fellow-servant, does it necessarily follow that the loss will be ultimately borne by the master? Who will ultimately bear such loss? Who should bear it?

MANN *v.* O'SULLIVAN

126 California Reports 61 (1899)

GAROUTTE, J. This is an action to recover damages for personal injuries. The single question involved is, Does the complaint state a cause of action?

Defendant was the owner of a certain building in which she operated and maintained an elevator. As appears by the complaint "plaintiff was employed by said defendant to work for her in the capacity of a carpenter and to perform the work of inclosing the elevator shaft in said premises within a glass frame." While working at this employment "said defendant, through her servant, agent, and employee, one Emmet Carney, carelessly, negligently and without any warning or notice to plaintiff, and against his positive instructions not to operate the elevator herein mentioned at any time without notice to him, suddenly operated said elevator from the ground floor, where said elevator was standing, so that said elevator suddenly struck with great force the screening on which plaintiff was working as aforesaid; and that, by reason of the gross negligence and carelessness of said defendant in operating said elevator as aforesaid, said plaintiff sustained the injuries above mentioned."

The important matter presented by this appeal arises upon the solution of the question as to whether or not the plaintiff and Carney, the man operating the elevator, were fellow-servants. In other words, these two men being employed by defendant, were they employed "in the same general business"? (*Civil Code*, section 1970.) It is impossible to declare a rule of law by which all cases presenting this interesting question may be weighed and tested. In that excellent work, the *American and English Encyclopedia of Law*, VII, 864, it is said: "In the note will be found every authority it is believed, determining who are and who are not fellow-servants, alphabetically arranged according to the various occupations or employments." Yet, after a careful perusal of that note, we still find the same mist surrounding the question, and the legal atmosphere in no degree clarified. The authorities are widely divergent, and the text-writers appear to be unable to agree upon a satisfactory rule by which it may be determined who are fellow-servants, or what servants are engaged in a common employment, or, as the statute of this state has it, what servants are employed "in the same general business." Shearman and Redfield, in their work upon *Negligence* declare the rule as favorable to the servant as it can be found in any standard work, and that rule is declared in section 236: "Under the generally prevailing rule, fellow-servants are engaged in a common employment when each of them is occupied in service of such a kind that all the others in the exercise of ordinary sagacity ought to be able to foresee, when accepting their employment, that his negligence would

probably expose them to injury." Testing this case by the foregoing rule, the conclusion is irresistible that plaintiff, who was employed to repair the elevator shaft, and Carney, the man who was employed to operate the elevator, were servants of defendant, engaged in a common employment or as our statute has it, engaged "in the same general business." It was plain to the plaintiff when he began work in repairing the elevator shaft that the negligence of Carney would expose him to great danger. He recognized the fact that danger was present with him, for he instructed Carney not to raise the elevator without a notification to him, in order that he might first remove to a place of safety. The conclusion arrived at in many cases rests upon the principle that the danger from the negligence of another employee being fairly apparent, it should be held that all other employees assume the risk incident to that danger; and this principle forms the foundation of the rule which we have quoted from Shearman and Redfield.

We will notice a few cases where the facts and principle invoked appear to be similar to those here presented. In *Besel* v. *N.Y.C. Railroad Co.*, 70 N.Y. 177, it is held that a car repairer working upon a car was in common employment with the men in charge of a train not connected with the car upon which the repairer was doing the work. To the same effect is *Corcoran* v. *Deleware, etc., Railroad Co.*, 126 N.Y. 673, and *Campbell* v. *Pennsylvania Railroad Co.* (Penn., Jan. 4, 1886), 24 Am. & Eng. R.R., Cas. 427. In *Hasty* v. *Sears*, 157 Mass. 123, 34 Am. St. Rep. 267, a case identical in its facts with the one before us, the court said: "The plaintiff and the elevator boy were both servants of the defendant at the time of the plaintiff's injury, and, as their employment was a common employment, the negligence of the boy in running the car down upon the plaintiff was an obvious risk which the plaintiff assumed, and for which the defendant is not answerable to him. The plaintiff and the boy were both working to secure the successful operation of the elevator, the plaintiff in repairing it and the boy in operating the car, and they were forwarding a common enterprise for the benefit of the defendant, and were in common employment." In *Pagundes* v. *C.P. Railroad Co.*, 79 Cal. 97, it is held that a laborer working upon the railroad track is a fellow-servant with a conductor and a track-walker. In *Livingstone* v. *Kodak Packing Co.*, 103 Cal. 263, it is held that the mate of a vessel and a waiter at the table are engaged "in the same general business" in the sense of those words as used in section 1970 of the Civil Code. The court declared that the general business of the defendant was

the carrying of freight and passengers upon its steamer; that in the conduct of that business a waiter was as necessary an employee as a mate, and both were essentially necessary for the proper conduct of the business. In the case at bar, it may be said that the business of defendant was operating and maintaining an elevator. A boy or man to manipulate it was a necessity, and likewise an engineer to handle the engine and furnish the power, and likewise a man to repair the machine itself when out of order. These men in their respective lines of vocation were necessary to the operation of the machine, and were assisting in the same general business of operating and maintaining the machine. The man to repair the elevator when it was out of order was as necessary as the waiter to the ship, or the repairer to the car, or the laborer to the railroad track. The allegation of the plaintiff that he was employed by the defendant in the capacity of a carpenter to do certain work for her, and that at the time he received the injury complained of he was doing the work for which he was employed "under the direction of the defendant" shows that he was not an independent contractor, and precludes him from invoking the principles declared in *Bennett* v. *Trubody*, 66 Cal. 510, 56 Am. Rep. 117. The defendant would have been liable to a stranger for any injury sustained by reason of his negligence upon the ground that he was the servant of the defendant.

It is also claimed that from the face of the complaint it appears that the accident occurred from the negligence of the defendant herself. The pleading does not bear this construction. After stating that the accident occurred by reason of Carney operating the elevator, the pleading then declares that "defendant did thereby negligently and carelessly precipitate with great force," et cetera. The complaint further declares that "by reason of the gross negligence and carelessness of said defendant in operating said elevator as aforesaid, said plaintiff sustained the injuries," et cetera. It is entirely plain from these allegations that the elevator was being operated by Carney and that by reason of his negligence in so operating it the accident occurred. By any reasonable construction of the pleading it contains nothing indicating negligence upon the part of anyone except Carney.

It is next insisted that if plaintiff and Carney were fellow-servants and engaged in the same general business, then that fact should be pleaded in the answer. It is sufficient to say that if the facts alleged in the complaint show that the servants are fellow-servants and engaged in the same general business, then that fact may be taken advantage of by demurrer.

It is also declared that it was the duty of the master to warn plaintiff when the elevator was about to start. If there had been an express agreement to that effect made by the master and the servant, the plaintiff, when he was hired to do the work, there might be some force in this contention. (*Bradley* v. *N.Y.C. Railroad Co.*, 62 N.Y. 99.) But plaintiff went to work without any such agreement, and acted alone upon the confidence he had in a compliance with the request he made to the elevator man, Carney, to give him notice of the starting of the cage.

For the foregoing reasons the judgment (for defendant) is affirmed.

QUESTIONS

1. What test is laid down in the principal case for determining whether given employees are fellow-servants?
2. "Fellow-servants are engaged in common employment when each of them is occupied in such employment that all the others in the exercise of ordinary sagacity ought to be able to foresee, when accepting their employment, that the negligence of one of them would probably expose the others to injury." Comment on this test.
3. Some courts hold that given employees are fellow-servants "when they are co-operating at the time of the injury in the particular business in hand, or whose usual duties are such as to bring them into habitual association or into such relations that they can exercise an influence upon each other promotive of proper caution." Comment on this test.
4. Some cases hold that where the master's business is an extensive one, the fellow-servant rule should apply only to those servants who are working together in the same general department. Comment on this test.
5. Through the negligence of an engineer of the D Company, P, a day laborer, working on the right of way, is injured. P sues the company for damages. What decision?
6. P, a fireman on a train, sues the D Company for an injury caused by the negligence of X, the engineer. The company relies on the fellow-servant rule as a defense. What decision?
7. P, a flagman on one of D's trains, is injured by the negligence of the engineer on another train of the company. P sues the company for damages. What decision?
8. The X Company runs its trains over the tracks of the D Company. P, an engineer, in the employ of the X Company, is injured through the negligence of Y, a switchman in the employ of the D Company. P sues the D Company for damages. What decision?

LAMSON *v.* AMERICAN AXE AND TOOL COMPANY

177 Massachusetts Reports 144 (1900)

Tort, under the employer's liability act, St. 1887, c. 270, for personal injuries occasioned to the plaintiff while in the defendant's employ. Trial in the Superior Court, before LAWTON, J., who directed the jury to return a verdict for the defendant; and the plaintiff alleged exceptions, which appear in the opinion.

HOLMES, C. J. This is an action for personal injuries caused by the fall of a hatchet from a rack in front of which it was the plaintiff's business to work at painting hatchets, and upon which the hatchets were to be placed to dry when painted. The plaintiff had been in the defendant's employment for many years. About a year before the accident new racks had been substituted for those previously in use, and it may be assumed that they were less safe and were not proper, but were dangerous on account of the liability of the hatchets to fall from the pegs upon the plaintiff when the racks were jarred by the motion of machinery near by. The plaintiff complained to the superintendent that the hatchets were more likely to drop off than when the old racks were in use, and that now they might fall upon him, which they could not have done from the old racks. He was answered in substance that he would have to use the racks or leave. The accident which he feared happened, and he brought this suit.

The plaintiff, on his own evidence, appreciated the danger more than anyone else. He perfectly understood what was likely to happen. That likelihood did not depend upon the doing of some negligent act by people in another branch of employment, but solely on the permanent conditions of the racks and their surroundings and the plaintiff's continuing to work where he did. He complained, and was notified that he could go if he would not face the chance. He stayed and took the risk. *Carrigan* v. *Washburn & Moen Manufacturing Co.*, 170 Mass. 79. See *Lewis* v. *New York & New England Railroad*, 153 Mass. 73; *Prentiss* v. *Kent Furniture Manufacturing Co.*, 63 Mich. 478. He did so none the less that the fear of losing his place was one of his motives. *Leary* v. *Boston & Albany Railroad*, 139 Mass. 580; *Haley* v. *Case*, 142 Mass. 316; *Westcott* v. *New York & New England Railroad*, 153 Mass. 460.

Exceptions overruled.

QUESTIONS

1. Was not the defendant in this case guilty of negligence? If so, why was the plaintiff not permitted to recover damages?
2. What would have been the decision in the principal case if the plaintiff had remained in the defendant's employ not knowing or appreciating the danger in question?
3. P is injured in the course of his employment by the negligence of his employer, D. P sues D for damages. D pleads that P, in consideration of his employment, agreed to release him from all liability for negligence. P contends that the contract is illegal and void. What decision?
4. What would have been the decision in the principal case if the defendant had promised to remedy the situation but had not when, two weeks later, the plaintiff was injured?
5. P knows that X, a fellow-servant, is incompetent but remains in D's employ without making any complaint to D about X. Later P is injured through the negligence of X. What decision in an action by P against D?
6. P appreciates the unsafeness of his place of work but continues in D's employ without complaint. P is later injured because of the unsafe condition of D's premises. What decision in an action by P against D?

SOLT *v.* WILLIAMSPORT RADIATOR COMPANY

231 Pennsylvania State Reports 585 (1911)

MOSCHZISKER, J. On May 23, 1909, the plaintiff, a man then forty-nine years of age, while working at the manufacturing establishment of the defendant company, suffered a fracture of the left arm which necessitated its amputation. He had been employed by the defendant for about two years before the accident, and had been working for nearly two years at the particular kind of employment in which he suffered his injury. In the manufacture of radiators the defendant used what are termed "rattlers," horizontal iron drums in which are placed the rough castings for the purpose of cleaning and smoothing. It was part of the plaintiff's duty to keep these rattlers running. They are revolved by means of belts extending to and connected with pulleys on a line-shaft attached to the ceiling some ten or twelve feet overhead. When the plaintiff came to work on the morning of the accident he found that one of these belts was off the line-shaft pulley. The defendant had no belt-shifters or other mechanical contrivances for the purpose of throwing the belts on or off, and it was the habit of the men employed about the establishment to replace them by climbing a ladder to the line-shaft and adjust-

ing the belts by the aid of a piece of stick of wood, which was kept for that purpose; and this the plaintiff attempted to do. He testified: "I crawled up on [the ladder] there to put that belt on. I was holding the belt in one hand and the stick in the other, and I shoved it in as carefully as I could, but the stick caught and my arm went right under, but after that, I do not know what happened." He said that it was all over so quickly that he could not tell exactly how the accident occurred, but that he thought his arm must have got caught between the belt and the pulley. He further stated that the shaft was running "full blast"; and uncontroverted testimony of the defendant shows this to have been between 270 and 280 revolutions per minute. The plaintiff said that he had attempted to put the belt on "just as I had seen others put them on." He also said "I think that [slowing down] would be the right way to put on belts, as near as I can tell you," and "to stop the engine—would be the safest way, I think." In answer to the question, "Then you think, if the line-shaft was slowed down, you could put on the belt without danger?" he said, "It stands to reason that a fellow could put it on easier than running full speed." And he admitted that he had known the line-shaft to have been "slowed down—once in a while, but not very often," for the purpose of putting on belts. Certain testimony of the defense relied upon by the plaintiff shows an admission on the part of several of the witnesses that they did not always have the engine closed down when readjusting the small belts, and that they used their own "judgment" in the matter, and were "willing to take a chance occasionally"; but these same witnesses all said that it was a dangerous thing to do, one of them stating that to put on a belt when the machinery was in full operation was at "the risk of your life."

While the trial judge affirmed a request for charge to the effect that "the plaintiff used the most dangerous method for adjusting a belt to a fast revolving line-shaft pulley," yet he refused to give binding instructions for the defendant, and after the verdict was rendered for the plaintiff the court below refused to enter judgment *non obstante veredicto*. There are several assignments of error, but it is only necessary for the purpose of determining this case to pass upon the seventh and eighth which go to the point just indicated.

The act of May 2, 1905, P.L. 352, section 11, provides: "The owner or person in charge of an establishment where machinery is used shall provide belt-shifters or other mechanical contrivances for the purpose of throwing on or off belts or pulleys." The non-

compliance of the defendant with the provisions of this act constituted negligence, and if the plaintiff was not plainly guilty of contributory negligence, the case was for the jury; but if his own negligence did contribute to the accident, then binding instructions should have been given in favor of the defendant. *Jones* v. *American Caramel Co.*, 225 Pa. St. 644.

To do an obviously dangerous thing which one is required to do in order to perform the duties of one's employment is an assumption of a risk, but not necessarily contributory negligence. If the statutory law requires guards against such a risk, and the employer has failed to comply with such a requirement, the defense of assumption of risk is not available to him, and in the absence of contributory negligence, the plaintiff can recover. But to do an act necessary to the performance of the duties of one's employment in a way which is obviously dangerous when one can perform the act in another way known to him, which is reasonably safe, is contributory negligence which will bar a recovery, even though the employer may have been negligent in not complying with the requirements of the statute.

The testimony in this case justifies but one conclusion, and that is that the plaintiff undertook to do an obviously dangerous act when he attempted to adjust the belt while the shaft was running at full speed. "Where two ways of discharging the service are apparent to an employee, one dangerous and the other safe or reasonably so, the employee must select the latter, whether or not it is the less convenient to him; and if he chooses the former, and the danger is such that a reasonably prudent man would not incur the risk under the same circumstances, he is guilty of such negligence as will bar recovery, although the master may also have been negligent." *American and English Encyclopedia of Law*, XX (2d ed.), 146. The habitual carelessness of his fellow-workmen does not justify the plaintiff, and it will not do to say that he lacked proper instructions or appreciation of the danger, for he was a mature man who had been working around machinery for a considerable length of time before the accident, and in addition to this he acknowledges in his testimony that there was another and safer way of doing this work than the one he pursued. This unfortunate man has suffered a great loss, but, since his own carelessness contributed directly to the happening of the accident, the law does not permit him to recover, and the case should not have been submitted to the jury.

Judgment of the court below is reversed and is here entered for the defendant.

QUESTIONS

1. But for the negligence of the defendant in this case the plaintiff would not have been injured. Why then was judgment given for the defendant?
2. P, an employee of D, worked at night and in his work passed to and fro on a platform constructed and maintained by D. D furnished P a lantern to use while engaged in his work. One night while working without the lantern P sustained an injury. P sues D for damages alleging and proving that the platform was an unsafe place on which to work. D contends (1) that P, by remaining in his employ with knowledge of the unsafeness of the platform, assumed the risk of injury; and (2) that, in any event, his injury was caused by his contributory negligence in not having with him his lantern when he was injured. What decision?
3. P, a switchman in the employ of D, negligently exposed himself to danger by walking on an open trestle in front of a moving switch engine. X, the engineer, saw the perilous position of P but applied the brakes too late to avoid hitting him. X was an incompetent employee and his incompetency was known to D. P sues D for damages. D's defense was the contributory negligence of P. What decision?
4. Under the common law the right of action for damage for a negligent injury resulting in death did not survive in favor of the next of kin or personal representative of the deceased. What is the explanation of this rule? Does the rule still obtain?

ii. RISKS NOT ASSUMED BY THE EMPLOYEE

SAUNDERS *v.* EASTERN HYDRAULIC BRICK COMPANY

63 New Jersey Law 554 (1899)

MAGIE, C. J. The judgment in this record was founded upon a nonsuit directed by the trial judge at the trial of the issue made by the pleadings. The action was in tort for damages for an injury suffered by plaintiff. The bill of exceptions shows that the direction of the trial judge proceeded upon the ground that the evidence did not establish any liability on the part of the defendant to answer for the injury received by the plaintiff for which he was prosecuting his suit, and upon the further ground that plaintiff's conduct was negligent and his negligence contributed to his injury.

The sole ground of complaint urged for the reversal of the judgment is the alleged error of the trial judge in directing the nonsuit.

At the time the nonsuit was allowed the evidence may be considered to have established the following facts: Plaintiff was a workman in the employ of the defendant. One of the defendant's buildings

in which it carried on its business had a roof, nearly flat, in which was a "skylight" fitted for two panes of glass, 20×40. The skylight was on about the same plane as the roof, and there was what plaintiff calls a "mutton," meaning no doubt, a mullion, dividing the frame and sustaining the contiguous parts of the panes of glass. One of the panes was broken, and plaintiff, who was a glazier, was directed by someone having authority from defendant to go upon the roof and put a new pane in the place of the broken one. In attempting to do this, plaintiff put his hand upon the centerpiece or mullion and leaned with so much of the weight of his body upon it as to break it. He had assumed such an attitude or position that, upon the breaking of the centerpiece, he fell headforemost through the window and received by that fall the injury of which he complained.

The rule of duty of the master applicable to the case admits of no doubt or dispute. He is bound to take reasonable care to have the place in which he directs his servant to work reasonably safe for the doing of that work, and free from latent or concealed dangers. *Electric Co.* v. *Kelley*, 28 Vroom 100; *Comben* v. *Bellville Stone Co.*, 30 Id. 226. Had plaintiff received his injury by falling through the roof on which he was directed to work, by reason of a defect in its construction, he might claim that defendant was liable for his injury, and a question for a jury would arise whether the master, in respect to the construction of the roof, had used the required care. Under such circumstances the roof was a place furnished by the master for his servant to work upon.

But the purpose of the mullion in this skylight was to aid in the support of the panes of glass. The master's duty was to have it so constructed as to reasonably answer that purpose, but it is impossible to discover any ground in reason for imposing upon the master any duty to have it so constructed as to bear the weight or any part of the weight of a servant, although engaged in repairing it.

The duty of the master in this respect is like that of one who invites another to make use of some place or appliance and is limited to the care requisite for the reasonable use thereof for the purpose for which it is designed. *New York and New Jersey Telephone Co.* v. *Speicher*, 30 Vroom 23; S.C. 31 Id. 242.

Doubtless the work of replacing the glass would have required the use of some force upon the mullion to remove the old putty. The case indicates that the mullion broke under plaintiff's pressure before he had begun to exert force for that purpose. In that aspect

it is plain that defendant was not liable for plaintiff's injury, because, as just stated, it owed him no duty to furnish mullion strong enough to bear his weight or any part of it.

The judgment must be affirmed.

QUESTIONS

1. Why should the master be under a duty to furnish his employees a reasonably safe place in which to work? Did the defendant in the principal case furnish the plaintiff with a reasonably safe place in which to work?
2. P was employed by D in the latter's warehouse. Frequently P went into D's manufacturing plant which was near the warehouse and idled there. While in the manufacturing plant on one occasion, P was injured as a result of the unsafeness of the premises. What decision in an action by P against D for damages?
3. D employed P and others to paint a building for him. The contract required P and others to build a scaffolding as they worked. P, while engaged in erecting the scaffolding, was injured by reason of the defective construction of the scaffolding. What decision in an action by P against D for damages?
4. Is the employer under any duty to warn an employee concerning the usual and ordinary dangers of his premises?
5. Is the employer under any duty to warn a servant concerning unusual or secret dangers of his premises? What is the effect of the employer's giving warning to his employees of secret and unusual dangers of the employer's premises?
6. P sustains an injury by reason of the unsafeness of his employer's premises. In an action by P against D for damages, D pleads that P knew of the unsafeness of the premises and raised no objection. What decision?

RICHMOND & DANVILLE RAILROAD COMPANY *v.* JONES

92 Alabama Reports 218 (1890)

This action was brought by D. W. Jones, against the appellant corporation, to recover damages for personal injuries alleged to have been inflicted by reason of the negligence of the defendant. There were three counts in the complaint. The first count sought to recover on the ground that the injuries were caused by reason of defects in the condition of the ways, works, machinery, or plant connected with or used in the employ of defendant.

The circumstances of the accident are substantially as follows: The plaintiff was in the employ of defendant as switchman and went

between the cars while in motion for the purpose of uncoupling them, and while between the cars he gave a signal, by means of his lantern, for the engine to go ahead, and at the time the cars which had been uncoupled rolled off from the engine a distance of four or five feet, and the engine instead of going ahead backed and struck the uncoupled cars, by means of which collision the plaintiff, who was still standing on the footboard of the tender of the engine, was mashed, mangled, and bruised, for which injury he brings this action.

The evidence is conflicting in many particulars. The testimony of the plaintiff tends to show that the drawhead of the tender of the engine was defective, and that in the discharge of the duties incumbent upon him as employee of the defendant, it was necessary that he should go between the moving cars; that while there and after he had uncoupled the cars, he gave a signal to the engineer, through the fireman, to go ahead, and that this signal was not obeyed. The testimony of the defendant contradicts all of these facts. The facts and circumstances attending the offer of the defendant to introduce in evidence the written contract of employment between the plaintiff and the defendant, to which plaintiff objected, are sufficiently set out in the opinion. There were many objections on the part of the defendant to evidence, introduced by the plaintiff, going to show that the drawhead used on the engine in question was defective. On the examination of one of the witnesses for the plaintiff he was asked by the plaintiff if the drawhead on the engine upon which plaintiff was riding was such as were ordinarily used on well-regulated railroads. Upon objection by the defendant to this question, the court asked the witness the following question: "Do you know how drawheads used on well-regulated roads compare with the said drawhead in question, used in the defendant's yards?" to which the witness answered that he did. The court then asked: "How do said drawheads compare with those used by well-regulated and well-conducted railroads?" Witness answered that he "did not think they compared very favorably." To each of these questions by the court and to the answers thereto the defendant separately and severally objected and reserved an exception to the court's overruling its said objections.

There was judgment for the plaintiff; and defendant prosecutes this appeal, and assigns the various rulings of the court as error.

COLEMAN, J. The suit was brought by appellee to recover damages for personal injury. For defense to the action, by way of special plea, the defendant set up Rule No. 23, which will be found in the

statement of the facts of the case. To this plea a demurrer was sustained. In the case of the *Louisville & Nashville Railroad* v. *Orr*, 91 Ala. 548; 8 So. Rep. 360, it is declared that "Railroads cannot stipulate for immunity from liability for their own wrongful negligence. A rule which imposes upon an employee to look after and be responsible for his own safety contravenes the law itself, which fixes the liability of railroads for negligence causing injury or death to their employees." The demurrer was properly sustained.

It is the duty of railroads to keep themselves reasonably abreast with improved methods so as to lessen the danger attendant on the service, and while they are not required to adopt every new invention, it is their duty to adopt such as are in ordinary use by prudently conducted roads engaged in like business, and surrounded by like circumstances. *Georgia Pacific Railway Co.* v. *Propst*, 83 Ala. 518. There have been such advancements in science, for the control of steam, and improvements in the machinery and appliances used by railroads, for the better security of life, limb, and property, that it would be inexcusable to continue to use old methods, machinery, and appliances known to be attended with more or less danger, when the danger could be reasonably avoided by the adoption of the newer and which are in general used by well-regulated railroads. Not that it is required of them to adopt every new invention useful in the business, although it may serve to lessen danger, but it is their duty to discontinue old methods which are insecure, and to adopt such improvements and advancements as are in ordinary use by prudently conducted roads engaged in like business and surrounded by like circumstances. *Louisville & Nashville Railway Co.* v. *Allen*, 78 Ala. 494. Applying this principle in the case of the *Georgia Pacific Railway Co.* v. *Propst*, 83 Ala. 526, the court held that "if the drawheads and bumpers used by defendant were such as were employed by many well conducted roads, this would repel all imputation of negligence founded on mere structure, although other roads, even a majority of them, adopted a different pattern." Witnesses who have sufficient knowledge of the subject may testify to the general rules of railroads on the subject. The same general principle is declared in the case of *Louisville & Nashville Railway Co.* v. *Hall*, 87 Ala. 707. Under these rules, we think it was proper to inquire whether the drawheads used by defendant, when the injury occurred, was such as were usually used on well-regulated railroads. The witnesses were shown to be experts, and were competent to give such testimony.

Affirmed.

QUESTIONS

1. The court at the trial of this case admitted evidence that the drawhead used by the defendant in this case did not compare favorably with drawheads used by other companies. What was the justification for admitting this evidence?
2. P has in his possession a tool defective for the purpose for which it is intended. While using it for a purpose for which it was not intended, P receives a serious injury because of its defective character. P sues D for damages. What decision?
3. P was injured by the explosion of the boiler of an engine which he was operating. The explosion occurred as a result of broken and corroded stay bolts. The engine had been sent several times to the shops for repairs, but the defects in question were never entirely remedied. P sues for damages. What decision?
4. In the foregoing case, P knows of the defects in the boiler but continues in D's employ without making any complaints. P sues D for damages resulting from an explosion caused by the defects. What decision?
5. When P learned of the defects in question he immediately notified his employer of them. His employer promised to make the necessary repairs. Two weeks later, before the repairs have been made, an explosion occurred resulting in P's injury. What decision in an action by P against D for damages?
6. Is an employer under a duty to inspect and repair tools, appliances, and machinery? If so, what is the scope of this duty?
7. By what standard is the safeness of tools, appliances, and machinery to be tested?

NORFOLK & WESTERN RAILROAD COMPANY *v.* HOOVER

79 Maryland Reports 253 (1894)

McSherry, J. This is an action brought to recover damages for personal injuries received by the appellee, an employee of the Norfolk and Western Railroad Co., as a result of alleged negligence on the part of his fellow-servants. The verdict and judgment were in his favor, and the company has appealed. In the record there are three bills of exceptions upon which the questions to be considered arise. Two of these exceptions were reserved by the appellant and one by the appellee.

It appears that in May, 1891, an extra train of loaded freight cars was started from Shenandoah, Virginia, about eleven-thirty P.M., to run through to Hagerstown, Maryland. The crew consisted of a conductor, an engineman, a fireman, a flagman, and two brakemen.

Hoover, the appellee, was the engineman. As the train proceeded northward, it descended some heavy grades, and the engineman noticed that its speed was not kept under proper control by the brakeman. At Luray the train laid over for an hour, and the engineman requested the brakeman not to let him down the hills so rapidly, as the night was quite foggy. After leaving Luray they ascended the grade to Vaughn's Summit, turning that point at a speed of about ten miles an hour. Immediately upon passing the Summit, the appellee shut off the steam so that the train might descend by gravity alone, without aid from the engine. When about a train's length over the hill he discovered that the train was increasing its speed, and he applied the tank brake; but this producing no effect, he blew for brakes, turned on the driver brakes and applied sand to the track. This not checking the train, he again blew for brakes and reversed his engine. He repeated his signal for brakes at least once, and probably twice afterward, but they seem not to have been heeded by the brakemen, for the train moved rapidly onward down the grade. The packing blew out of the cylinder, and this caused the train to plunge forward, throwing the appellee back into the tender. At this juncture, as they were rapidly approaching, and were only some ten or twelve car lengths distant from, Possum Hollow, which is crossed upon a trestle seventy-five or eighty feet high, the appellee saw that a collision with another freight train standing or moving very slowly northward on the trestle, was imminent and unavoidable; and to save himself, jumped from his engine and received the injuries for which he has brought the pending suit.

There was evidence offered tending to prove that Huyett, one of the brakemen, had been drinking that night before the accident happened; and within thirty minutes prior to the collision his breath gave unmistakable evidence of it. In this state of the proof, a witness was asked whether he knew the general reputation of Huyett and Reese, the two brakemen, for sobriety for one or two years before the accident and following that; and if so, to state what that reputation was. To this question and the evidence sought to be elicited thereby, the appellant objected, but the court permitted the question to be asked and answered, and this ruling forms the subject of the first exception.

It has been repeatedly held by this court, and is the settled and established doctrine of Maryland, that in actions of this character, where a servant sues his master for injuries resulting from the negli-

gence of a fellow-servant, the plaintiff, to succeed, must prove, not only that some negligence of the fellow-servant caused the injury, but also that the master has himself been guilty of negligence, either in the selection of the negligent fellow-servant in the first instance, or in retaining him in his service afterward. Mere negligence on the part of the fellow-servant, though resulting in an injury, will not suffice to support the action, because the master does not insure one employee against the carelessness of another. But he owes to each of his servants the duty of using reasonable care and caution in the selection of competent fellow-servants, and in the retention in his service of none but those who are. If he does not perform this duty, and an injury is occasioned by the negligence of an incompetent or careless servant, the master is responsible to the injured employee, not for the mere negligent act or omission of the incompetent or careless servant, but for his own negligence in not discharging his own duty toward the injured servant. As this negligence of the master must be proved, it may be proved like any other fact, either by direct evidence or by the proof of circumstances from which its existence may, as a conclusion of fact, be fairly and reasonably inferred. That drunkenness on the part of a railroad employee renders him an incompetent servant will scarcely be disputed; nor can it be questioned that a master who knowingly employs such a servant, or who, knowing his habits, retains him in his service, would be guilty of a reckless and wanton breach of duty, not only to the public but to every employee in his service. There is no evidence in the record, nor has there been a suggestion, that either the conductor, fireman, or flagman of the train was negligent or incompetent. The negligence which directly caused the accident is attributed solely to the brakemen; and the appellant's negligence which, as it is claimed, fixed its liability, lies in its employment of, or continuing to retain in its service, these dissipated or intemperate brakemen. But, as we have stated, it was necessary for the plaintiff to show not only their employment, but that the company had not used due and ordinary care in selecting them. There was no direct evidence adduced to show the absence of such care; but the question excepted to, and the evidence elicited in response to it, were designed to show by indirect or circumstantial evidence that the company had not used the degree of care and caution in the selection of these brakemen that its duty imperatively required it to use. So the question is, Can you fix upon the master a failure to use due care in selecting careful servants

by showing such notorious or general reputation respecting the servant's unfitness or incompetency as that the master could not, without negligence on his part, have been ignorant of it when he employed the servant? About this there ought to be no difficulty. If the servant's general reputation before employment is so notorious as to unfitness as that it must have been known to the master but for his, the master's, negligence in not informing himself—if he could have been ignorant of it only because he failed to make investigation—then, it is obvious that he has not used the care and caution which the law demands of him in selecting his employees. Hence, "the servant's general reputation for unfitness may be sufficient to overcome the presumption that the master used due care in his selection, even though actual knowledge of such reputation for unfitness on the master's part is not shown." Wood, *Master and Servant*, section 420. In *Davis* v. *The Detroit & Milwaukee Railroad Co.*, 20 Mich. 124, COOLEY, J., speaking for the court, adopts the case of *Gilman v. Eastern Railroad Corporation*, 10 Allen, 223, which puts upon the employer the responsibility of negligently employing an unfit person, generally known and reputed to be such, notwithstanding the employer may in fact have been ignorant of such unfitness. Continuing, he said: "The ignorance itself is negligence in a case in which any proper inquiry would have obtained the necessary information, and where the duty to inquire was plainly imperative."

The evidence offered and admitted had no relation to specific or isolated acts of negligence. These, unless brought home to the knowledge of the master, would not have been admissible as reflecting on the question of the master's care. *Baltimore Elevator Co.* v. *Neal*, 65 Md. 438. We think, for the reasons we have given, and upon the authorities we have cited, there was no error committed in allowing the question excepted to in the first bill of exception to be put and answered.

Under this ruling quite a number of witnesses testified to Huyett's general reputation for intemperance, extending from a period long anterior to his employment by the appellant up to and after the accident. One witness, Eyler, gave evidence as to Reese's general reputation. With respect to Huyett, the evidence, if credited by the jury, showed a general reputation covering many years uninterruptedly and of such a notorious character that a jury might well have inferred it was known to the master when Huyett was employed, or else that the master failed to know it only because of neglecting

to make proper inquiry. There was, consequently, evidence legally sufficient to go to the jury upon the subject of the company's negligence, and, therefore, there was no error in rejecting the appellant's first and fifth prayers which sought to take the case from the consideration of the jury, nor in rejecting its fourth prayer, which sought to exclude this evidence from the case.

Affirmed.

QUESTIONS

1. Did it appear in this case that the defendant knew of the incompetency of the brakemen? If not, why should it be held responsible for their negligence on the occasion in question?
2. Did the defendant's negligence consist in negligently employing incompetent brakemen or in retaining them in its employment after knowing of their incompetency?
3. Suppose that the engineer had known of the incompetency of the brakemen but had never made any report of the fact to his employer, would the decision in the principal case have been the same?
4. The D Company sent out a train with two brakemen when there should have been three. A wreck occurred which could have been avoided if the train had been manned by three brakemen. P, the conductor, sues for injuries sustained in the wreck. What decision?
5. It is usually said that the master is under a duty to make reasonable rules and regulations for the government of the operations of his business, particularly where those operations are dangerous and complex, and that the master is under a duty to use reasonable care in seeing that these rules and regulations are enforced. Why should these duties be imposed upon a master?

b) Under Modern Legislation

i. IN GENERAL

NEW YORK CENTRAL RAILROAD COMPANY *v.* WHITE

243 United States Reports 188 (1916)

PITNEY, J. A proceeding was commenced by defendant in error before the Workmen's Compensation Commission of the State of New York, established by the Workmen's Compensation Law of that state,[1] to recover compensation from the New York Central & Hudson River Railroad Co. for the death of her husband, Jacob White, who lost his life September 2, 1914, through an accidental

[1] Chapter 816, Laws 1913, as re-enacted and amended by c. 41, Laws 1914, and amended by c. 316, Laws 1914.

injury arising out of and in the course of his employment under that company. The commission awarded compensation in accordance with the terms of the law; its award was affirmed, without opinion, by the Appellate Division of the Supreme for the Third Judicial Department, whose order was affirmed by the Court of Appeals, without opinion. 169 App. Div. 903; 216 N.Y. 653. Federal questions having been saved, the present writ of error was sued out by the New York Central Railroad Co., successor, through a consolidation of corporations, to the rights and liabilities of the employing company. The writ was directed to the Appellate Division, to which the record and proceedings had been remitted by the Court of Appeals. *Sioux Remedy Co.* v. *Cope*, 235 U.S. 197, 200.

The errors specified are based upon these contentions: (1) That the liability, if any, of the railroad company for the death of Jacob White is defined and limited exclusively by the provisions of the Federal Employers' Liability Act of April 22, 1908, c. 149, 35 Stat. 65;[1] and (2) that to award compensation to defendant in error under the provisions of the Workmen's Compensation Law would deprive plaintiff in error of its property without due process of law, and deny to it the equal protection of the laws, in contravention of the Fourteenth Amendment.

We turn to the constitutional question. The Workmen's Compensation Law of New York establishes forty-two groups of hazardous employments, defines "employee" as a person engaged in one of these employments upon the premises or at the plant or in the course of his employment away from the plant of his employer, but excluding farm laborers and domestic servants; defines "employment" as including employment only in a trade, business, or occupation carried on by the employer for pecuniary gain; "injury" and "personal injury" as meaning only accidental injuries arising out of and in the course of employment, and such disease or infection as naturally and unavoidably may result therefrom; and requires every employer subject to its provisions to pay or provide compensation according to a prescribed schedule for the disability or death of his employee resulting from an accidental personal injury arising out of and in the course of the employment, without regard to fault as a cause except where the injury is occasioned by the wilful intention of the injured employee to bring about the injury or death of him-

[1] Discussion of this point omitted.

self or of another, or where it results solely from the intoxication of the injured employee while on duty, in which cases neither the injured employee nor any dependent shall receive compensation. By section 11 the prescribed liability is made exclusive, except that, if an employer fail to secure the payment of compensation as provided in section 50, an injured employee, or his legal representative in case death results from the injury, may at his option elect to claim compensation under the act or to maintain an action in the courts for damages, and in such an action, it shall not be necessary to plead or prove freedom from contributory negligence, nor may the defendant plead as a defense that the injury was caused by the negligence of a fellow-servant, that the employee assumed the risk of his employment, or that the injury was due to contributory negligence. Compensation under the act is not regulated by the measure of damages applied in negligence suits, but in addition to providing medical, surgical, or other like treatment, it is based solely on loss of earning power, being graduated according to the average weekly wages of the injured employee and the character and duration of the disability, whether partial or total, temporary or permanent; while in case the injury causes death the compensation is known as a death benefit, and includes funeral expenses not exceeding one hundred dollars, payments to the surviving wife (or dependent husband) during widowhood (or dependent widowerhood) of a percentage of the average wages of the deceased, and if there be a surviving child or children under the age of eighteen years and additional percentage of such wages for each child until that age is reached. There are provisions invalidating agreements by employees to waive the right to compensation, prohibiting any assignment, release, or commutation of claims for compensation or benefits except as provided by the act, exempting them from the claims of creditors, and requiring that the compensation and benefits shall be paid only to employees or their dependents. Provision is made for the establishment of a Workmen's Compensation Commission[1] with administrative and judicial functions, including authority to pass upon claims to compensation on notice to the parties interested. The award or decision of the commission is made subject to an appeal, on questions of law only, to the Appellate Division of the Supreme Court for the Third Department, with an ultimate appeal to the Court of Appeals in

[1] By chap. 674, Laws 1915, secs. 2 and 8, this commission was abolished and its functions were conferred upon the newly created Industrial Commission.

cases where such an appeal would lie in civil actions. A fund is created, known as "the state insurance fund," for the purpose of insuring employers against liability under the law and assuring to the persons entitled the compensation thereby provided. The fund is made up primarily of premiums received from employers, at rates fixed by the commission in view of the hazards of the different classes of employment, and the premiums are to be based upon the total pay-roll and number of employees in each class at the lowest rate consistent with the maintenance of a solvent state insurance fund and the creation of a reasonable surplus and reserve. Elaborate provisions are laid down for the administration of this fund. By section 50, each employer is required to secure compensation to his employees in one of the following ways: (1) by insuring and keeping insured the payment of such compensation in the state fund; or (2) through any stock corporation or mutual association authorized to transact the business of workmen's compensation insurance in the State; or (3) "By furnishing satisfactory proof to the commission of his financial ability to pay such compensation for himself, in which case the commission may, in its discretion, require the deposit with the commission of securities of the kind prescribed in section thirteen of the insurance law, in an amount to be determined by the commission, to secure his liability to pay the compensation provided in this chapter." If an employer fails to comply with this section he is made liable to a penalty in an amount equal to the pro rata premium that would have been payable for insurance in the state fund during the period of non compliance; besides which, his injured employees or their dependents are at liberty to maintain an action for damages in the courts, as prescribed by section 11.

In a previous year, the legislature enacted a compulsory compensation law applicable to a limited number of specially hazardous employments, and requiring the employer to pay compensation without regard to fault. Laws 1910, chap. 674. This was held by the Court of Appeals in *Ives* v. *South Buffalo Railway Co.*, 201 N.Y. 271, to be invalid because in conflict with the due process of law provisions of the state constitution and of the Fourteenth Amendment. Thereafter, and in the year 1913, a constitutional amendment was adopted, effective January 1, 1914, declaring:

> Nothing contained in this constitution shall be construed to limit the power of the legislature to enact laws for the protection of the lives, health, or safety of employees; or for the payment, either by employers, or

by employers and employees or otherwise, either directly or through a state or other system of insurance or otherwise, of compensation for injuries to employees or for death of employees resulting from such injuries without regard to fault as a cause thereof, except where the injury is occasioned by the wilful intention of the injured employee to bring about the injury or death of himself or of another, or where the injury results solely from the intoxication of the injured employee while on duty; or for the adjustment, determination, and settlement, with or without trial by jury, of issues which may arise under such legislation; or to provide that the right of such compensation, and the remedy therefor, shall be exclusive of all other rights and remedies for injuries to employees or for death resulting from such injuries; or to provide that the amount for such compensation for death shall not exceed a fixed or determinable sum; provided that all moneys paid by an employer to his employees or their legal representatives, by reason of the enactment of any of the laws herein authorized, shall be held to be a proper charge in the cost of operating the business of the employer.

In December, 1913, the legislature enacted the law now under consideration (Laws, 1913, c. 816), and in 1914 re-enacted it (Laws, 1914, c. 41) to take effect as to payment of compensation on July 1 in that year. The act was sustained by the Court of Appeals as not inconsistent with the Fourteenth Amendment in *Matter of Jensen* v. *Southern Pacific Co.*, 215 N.Y. 514; and that decision was followed in the case at bar.

The scheme of the act is so wide a departure from common-law standards respecting the responsibility of employer to employee that doubts naturally have been raised respecting its constitutional validity. The adverse considerations urged or suggested in this case and in kindred cases submitted at the same time are: (*a*) that the employer's property is taken without due process of law, because he is subjected to a liability for compensation without regard to any neglect or default on his part or on the part of any other person for whom he is responsible, and in spite of the fact that the injury may be solely attributable to the fault of the employee; (*b*) that the employee's rights are interfered with in that he is prevented from having compensation for injuries arising from the employer's fault commensurate with the damages actually sustained, and is limited to the measure of compensation prescribed by the act; and (*c*) that both employer and employee are deprived of their liberty to acquire property by being prevented from making such agreement as they choose respecting the terms of the employment.

In support of the legislation, it is said that the whole common-law doctrine of employer's liability for negligence, with its defenses of contributory negligence, fellow-servant's negligence, and assumption of risk, is based upon fictions, and is inapplicable to modern conditions of employment; that in the highly organized and hazardous industries of the present day the causes of accident are often so obscure and complex that in a material proportion of cases it is impossible by any methods correctly to ascertain the facts necessary to form an accurate judgment, and in a still larger proportion the expense and delay required for such ascertainment amount in effect to a defeat of justice; that under the present system the injured workman is left to bear the greater part of industrial accident loss, which because of his limited income he is unable to sustain, so that he and those dependent upon him are overcome by poverty and frequently become a burden upon public or private charity; and that litigation is unduly costly and tedious, encouraging corrupt practices and arousing antagonisms between employers and employees.

In considering the constitutional question, it is necessary to view the matter from the standpoint of the employee as well as from that of the employer. For, while plaintiff in error is an employer, and cannot succeed without showing that its rights as such are infringed (*Plymouth Coal Co.* v. *Pennsylvania*, 232 U.S. 531, 544; *Jeffrey Manufacturing Co.* v. *Blagg*, 235 U.S. 571, 576), yet, as pointed out by the Court of Appeals in the *Jensen Case*, 215 N.Y. 526, the exemption from further liability is an essential part of the scheme, so that the statute if invalid as against the employee is invalid as against the employer.

The close relation of the rules governing responsibility as between employer and employee to the fundamental rights of liberty and property is of course recognized. But those rules, as guides of conduct, are not beyond alteration by legislation in the public interest. No person has a vested interest in any rule of law entitling him to insist that it shall remain unchanged for his benefit. *Munn* v. *Illinois*, 94 U.S. 113, 134; *Hurtado* v. *California*, 110 U.S. 516, 532; *Martin* v. *Pittsburgh & Lake Erie Railroad Co.*, 203 U.S. 284, 294; *Second Employers' Liability Cases*, 223 U.S. 1, 50; *Chicago & Alton Railroad Co.* v. *Tranbarger*, 238 U.S. 67, 76. The common law bases the employer's liability for injuries to the employee upon the ground of negligence; but negligence is merely the disregard of some duty

imposed by law; and the nature and extent of the duty may be modified by legislation with corresponding change in the test of negligence. Indeed, liability may be imposed for the consequences of a failure to comply with a statutory duty, irrespective of negligence in the ordinary sense; safety appliance acts being a familiar instance. *St. Louis, Iron Mountain & Southern Railway Co.* v. *Taylor*, 210 U.S. 281, 295; *Texas & Pacific Railway Co.* v. *Rigsby*, 241 U.S. 33, 39, 43.

The fault may be that of the employer himself, or—most frequently—that of another for whose conduct he is made responsible according to the maxim *respondeat superior*. In the latter case the employer may be entirely blameless, may have exercised the utmost human foresight to safeguard the employee; yet, if the *alter ego* while acting within the scope of his duties be negligent—in disobedience, it may be, of the employer's positive and specific command—the employer is answerable for the consequences. It cannot be that the rule embodied in the maxim is unalterable by legislation.

The immunity of the employer from responsibility to an employee for the negligence of a fellow-employee is of comparatively recent origin, it being the product of the judicial conception that the probability of a fellow-workman's negligence is one of the natural and ordinary risks of the occupation, assumed by the employee and presumably taken into account in the fixing of his wages. The earliest reported cases are *Murray* v. *South Carolina Railroad Co.* (1841), 1 McMull. (S.C.) 385, 398; *Farwell* v. *Boston & Worcester Railroad Corp.* (1842), 4 Metc. 49, 57; *Hutchinson* v. *York, Newcastle & Berwick Railway Co.* (1850), 5 Exch. 343, 351, 19 L.J. Exch. 296, 299, 14 Jur. 837, 840; *Wigmore* v. *Jay* (1850), 5 Exch. 354, 19 L.J. Exch. 300, 14 Jur. 838, 841; *Bartonsshill Coal Co.* v. *Reid* (1858), 3 Macq. H.L. Cas. 266, 284, 295. And see *Randall* v. *Baltimore & Ohio Railroad Co.*, 109 U.S. 478, 483; *Northern Pacific Railroad Co.* v. *Herbert*, 116 U.S. 642, 647. The doctrine has prevailed generally throughout the United States, but with material differences in different jurisdictions respecting who should be deemed a fellow-servant and who a vice-principal or *alter ego* of the master, turning sometimes upon refined distinctions as to grades and departments in the employment. See *Knutter* v. *New York & New Jersey Telephone Co.*, 67 N.J.L. 646, 650–53. It needs no argument to show that such a rule is subject to modification or abrogation by a state upon proper occasion.

The same may be said with respect to the general doctrine of assumption of risk. By the common law the employee assumes the risks normally incident to the occupation in which he voluntarily engages; other and extraordinary risks and those due to the employer's negligence he does not assume until made aware of them, or until they become so obvious that an ordinarily prudent man would observe and appreciate them, in either of which cases he does assume them, if he continue in the employment without obtaining from the employer an assurance that the matter will be remedied; but if he receives such an assurance, then, pending performance of the promise, the employee does not in ordinary cases assume the special risk. *Seaboard Air Line Railway* v. *Horton*, 233 U.S. 492, 504; 239 U.S. 595, 599. Plainly, these rules, as guides of conduct and tests of liability, are subject to change in the exercise of the sovereign authority of the state.

So, also, with respect to contributory negligence. Aside from injuries intentionally self-inflicted, for which the statute under consideration affords no compensation, it is plain that the rules of law upon the subject, in their bearing upon the employer's responsibility, are subject to legislative change; for contributory negligence, again, involves a default in some duty resting on the employee, and his duties are subject to modification.

It may be added, by way of reminder, that the entire matter of liability for death caused by wrongful act, both within and without the relation of employer and employee, is a modern statutory innovation, in which the states differ as to who may sue, for whose benefit, and the measure of damages.

It is true that in the case of the statutes thus sustained there were reasons rendering the particular departures appropriate. Nor is it necessary, for the purposes of the present case, to say that a state might, without violence to the constitutional guaranty of "due process of law," suddenly set aside all common-law rules respecting liability as between employer and employee, without providing a reasonably just substitute. Considering the vast industrial organization of the state of New York, for instance, with hundreds of thousands of plants and millions of wage-earners, each employer on the one hand having embarked his capital, and each employee on the other having taken up his particular mode of earning a livelihood, in reliance upon the probable permanence of an established body of law governing the relation, it perhaps may be doubted whether

the state could abolish all rights of action on the one hand, or all defenses on the other, without setting up something adequate in their stead. No such question is here presented, and we intimate no opinion upon it. The statute under consideration sets aside one body of rules only to establish another system in its place. If the employee is no longer able to recover as much as before in case of being injured through the employer's negligence, he is entitled to moderate compensation in all cases of injury, and has a certain and speedy remedy without the difficulty and expense of establishing negligence or proving the amount of the damages. Instead of assuming the entire consequences of all ordinary risks of the occupation, he assumes the consequences, in excess of the scheduled compensation, of risks ordinary and extraordinary. On the other hand, if the employer is left without defense respecting the question of fault, he at the same time is assured that the recovery is limited, and that it goes directly to the relief of the designated beneficiary. And just as the employee's assumption of ordinary risks at common law presumably was taken into account in fixing the rate of wages, so the fixed responsibility of the employer, and the modified assumption of risk by the employee under the new system, presumably will be reflected in the wage scale. The act evidently is intended as a just settlement of a difficult problem, affecting one of the most important of social relations, and it is to be judged in its entirety. We have said enough to demonstrate that, in such an adjustment, the particular rules of the common law affecting the subject-matter are not placed by the Fourteenth Amendment beyond the reach of the law-making power of the state; and thus we are brought to the question whether the method of compensation that is established as a substitute transcends the limits of permissible state action.

We will consider, first, the scheme of compensation, deferring for the present the question of the manner in which the employer is required to secure payment.

Briefly, the statute imposes liability upon the employer to make compensation for disability or death of the employee resulting from accidental personal injury arising out of and in the course of the employment, without regard to fault as a cause except where the injury or death is occasioned by the employee's wilful intention to produce it, or where the injury results solely from his intoxication while on duty; it graduates the compensation for disability according to a prescribed scale based upon the loss of earning power, having

regard to the previous wage and the character and duration of the disability; and measures the death benefits according to the dependency of the surviving wife, husband, or infant children.

Of course, we cannot ignore the question whether the new arrangement is arbitrary and unreasonable, from the standpoint of natural justice. Respecting this, it is important to be observed that the act applies only to disabling or fatal personal injuries received in the course of hazardous employment in gainful occupation. Reduced to its elements, the situation to be dealt with is this: Employer and employee, by mutual consent, engage in a common operation intended to be advantageous to both; the employee is to contribute his personal services, and for these is to receive wages, and ordinarily nothing more; the employer is to furnish plant, facilities, organization, capital, credit, is to control and manage the operation, paying the wages and other expenses, disposing of the product at such prices as he can obtain, taking all the profits, if any there be, and of necessity bearing the entire losses. In the nature of things, there is more or less of a probability that the employee may lose his life through some accidental injury arising out of the employment, leaving his widow or children deprived of their natural support; or that he may sustain an injury not mortal but resulting in his total or partial disablement, temporary or permanent, with corresponding impairment of earning capacity. The physical suffering must be borne by the employee alone; the laws of nature prevent this from being evaded or shifted to another, and the statute makes no attempt to afford an equivalent in compensation. But, besides, there is the loss of earning power; a loss of that which stands to the employee as his capital in trade. This is a loss arising out of the business, and, however it may be charged up, is an expense of the operation, as truly as the cost of repairing broken machinery or any other expense that ordinarily is paid by the employer. Who is to bear the charge? It is plain that, on grounds of natural justice, it is not unreasonable for the state, while relieving the employer from responsibility for damages measured by common-law standards and payable in cases where he or those for whose conduct he is answerable are found to be at fault, to require him to contribute a reasonable amount, and according to a reasonable and definite scale, by way of compensation for the loss of earning power incurred in the common enterprise, irrespective of the question of negligence, instead of leaving the entire loss to rest where it may chance to fall—that is, upon the injured employee or his dependents.

Nor can it be deemed arbitrary and unreasonable, from the standpoint of the employee's interest, to supplant a system under which he assumed the entire risk of injury in ordinary cases, and in others had a right to recover an amount more or less speculative upon proving facts of negligence that often were difficult to prove, and substitute a system under which in all ordinary cases of accidental injury he is sure of a definite and easily ascertained compensation, not being obliged to assume the entire loss in any case but in all cases assuming any loss beyond the prescribed scale.

Much emphasis is laid upon the criticism that the act creates liability without fault. This is sufficiently answered by what has been said, but we may add that liability of the carrier, of the innkeeper, of him who employed fire or other dangerous agency or harbored a mischievous animal, was not dependent altogether upon questions of fault or negligence. Statutes imposing liability without fault have been sustained. *St. Louis & San Francisco Railway Co.* v. *Mathews*, 165 U.S. 1, 22; *Chicago, Rock Island & Pacific Railway Co.* v. *Zernecke*, 183 U.S. 582, 586.

We have referred to the maxim, *respondeat superior*. In a well-known English case, *Hall* v. *Smith*, 2 Bing. 156, 160, this maxim was said by BEST, C. J., to be "bottomed on this principle, that he who expects to derive advantage from an act which is done by another for him, must answer for any injury which a third person may sustain from it." And this view has been adopted in New York. *Cardot* v. *Barney*, 63 N.Y. 281, 287. The provision for compulsory compensation, in the act under consideration, cannot be deemed to be an arbitrary and unreasonable application of the principle, so as to amount to a deprivation of the employer's property without due process of law. The pecuniary loss resulting from the employee's death or disablement must fall somewhere. It results from something done in the course of an operation from which the employer expects to derive a profit. In excluding the question of fault as a cause of the injury, the act in effect disregards the proximate cause and looks to one more remote—the primary cause, as it may be deemed—and that is, the employment itself. For this, both parties are responsible, since they voluntarily engage in it as coadventurers, with personal injury to the employee as a probable and foreseen result. In ignoring any possible negligence of the employee producing or contributing to the injury, the lawmaker reasonably may have been influenced by the belief that in modern industry the utmost diligence in the

employer's service is in some degree inconsistent with adequate care on the part of the employee for his own safety; that the more intently he devotes himself to the work, the less he can take precautions for his own security. And it is evident that the consequences of a disabling or fatal injury are precisely the same to the parties immediately affected, and to the community, whether the proximate cause be culpable or innocent. Viewing the entire matter, it cannot be pronounced arbitrary and unreasonable for the state to impose upon the employer the absolute duty of making a moderate and definite compensation in money to every disabled employee, or in case of his death to those who were entitled to look to him for support in lieu of the common-law liability confined to cases of negligence.

This, of course, is not to say that any scale of compensation, however insignificant on the one hand or onerous on the other, would be supportable. In this case, no criticism is made on the ground that the compensation prescribed by the statute in question is unreasonable in amount, either in general or in the particular case. Any question of that kind may be met when it arises.

But, it is said, the statute strikes at the fundamentals of constitutional freedom of contract; and we are referred to two recent declarations by this court. The first is this: "Included in the right of personal liberty and the right of private property—partaking of the nature of each—is the right to make contracts for the acquisition of property. Chief among such contracts is that of personal employment by which labor and other services are exchanged for money or other forms of property. If this right be struck down or arbitrarily interfered with, there is a substantial impairment of liberty in the long-established constitutional sense." *Coppage* v. *Kansas*, 236 U.S. 1, 14. And this is the other: "It requires no argument to show that the right to work for a living in the common occupations of the community is of the very essence of the personal freedom and opportunity that it was the purpose of the (Fourteenth) Amendment to secure." *Truax* v. *Raich*, 239 U.S. 33, 41.

It is not our purpose to qualify or weaken either of these declarations in the least. And we recognize that the legislation under review does measurably limit the freedom of employer and employee to agree respecting the terms of employment, and that it cannot be supported except on the ground that it is a reasonable exercise of the police power of the state. In our opinion it is fairly supportable upon that ground. And for this reason: The subject-matter in respect of

which freedom of contract is restricted is the matter of compensation for human life or limb lost or disability incurred in the course of hazardous employment, and the public has a direct interest in this as affecting the common welfare. "The whole is no greater than the sum of all its parts and when the individual health, safety, and welfare are sacrificed or neglected, the state must suffer." *Holden* v. *Hardy*, 169 U.S. 366, 397. It cannot be doubted that the state may prohibit and punish self-maiming and attempts at suicide; it may prohibit a man from bartering away his life or his personal security; indeed, the right to these is often declared, in bills of rights, to be "natural and inalienable"; and the authority to prohibit contracts made in derogation of a lawfully established policy of the state respecting compensation for accidental death or disabling personal injury is equally clear. *Chicago, Burlington & Quincy Railroad Co.*, v. *McGuire*, 219 U.S. 549, 571; *Second Employers' Liability Cases*, 223, U.S. 1, 52.

We have not overlooked the criticism that the act imposes no rule of conduct upon the employer with respect to the conditions of labor in the various industries embraced within its terms, prescribes no duty with regard to where the workmen shall work, the character of the machinery, tools, or appliances, the rules or regulations to be established, or the safety devices to be maintained. This statute does not concern itself with measures of prevention, which presumably are embraced in other laws. But the interest of the public is not confined to these. One of the grounds of its concern with the continued life and earning power of the individual is its interest in the prevention of pauperism, with its concomitants of vice and crime. And in our opinion, laws regulating the responsibility of employers for the injury or death of employees arising out of the employment bear so close a relation to the protection of the lives and safety of those concerned that they properly may be regarded as coming within the category of police regulations. *Sherlock* v. *Alling*, 93 U.S. 99, 103; *Missouri Pacific Railway Co.* v. *Castle*, 224 U.S. 541, 545.

The objection under the "equal protection" clause is not pressed. The only apparent basis for it is in exclusion of farm laborers and domestic servants from the scheme. But manifestly, this cannot be judicially declared to be an arbitrary classification, since it reasonably may be considered that the risks inherent in these occupations are exceptionally patent, simple, and familiar. *Missouri, Kansas & Texas Railway Co.* v. *Cade*, 233 U.S. 642, 650, and cases there cited.

We conclude that the prescribed scheme of compulsory compensation is not repugnant to the provisions of the Fourteenth Amendment, and are brought to consider, next, the manner in which the employer is required to secure payment of the compensation. By section 50, this may be done in one of three ways: (*a*) state insurance, (*b*) insurance with an authorized insurance corporation or association, or (*c*) by a deposit of securities. The record shows that the predecessor of plaintiff in error chose the third method, and, with the sanction of the commission, deposited securities to the amount of $300,000, under section 50, and $30,000 in cash as a deposit to secure prompt and convenient payment, under section 25, with an agreement to make further deposit if required. This was accompanied with a reservation of all contentions as to the invalidity of the act, and had not the effect of preventing plaintiff in error from raising the questions we have discussed.

The system of compulsory compensation having been found to be within the power of the state, it is within the limits of permissible regulation, in aid of the system, to require the employer to furnish satisfactory proof of his financial ability to pay the compensation, and to deposit a reasonable amount of securities for that purpose. The third clause of section 50 has not been, and presumably will not be, construed so as to give an unbridled discretion to the commission; nor is it to be presumed that solvent employers will be prevented from becoming self-insurers on reasonable terms. No question is made but that the terms imposed upon this railroad company were reasonable in view of the magnitude of its operations, the number of its employees, and the amount of its pay-roll (about $50,000,000 annually); hence no cricitism of the practical effect of the third clause is suggested.

This being so, it is obvious that this case presents no question as to whether the state might, consistently with the Fourteenth Amendment, compel employers to effect insurance according to either of the plans mentioned in the first and second clauses. There is no such compulsion, since self-insurance under the third clause presumably is open to all employers on reasonable terms such as it is within the power of the state to impose. Regarded as optional arrangements, for acceptance or rejection by employers unwilling to comply with that clause, the plans of insurance are unexceptionable from the constitutional standpoint. Manifestly, the employee is not injuriously affected in a constitutional sense by the provisions giving to the employer an option to secure payment of the compensation in either

of the modes prescribed, for there is no presumption that either will prove inadequate to safeguard the employee's interests.

Judgment affirmed.

QUESTIONS

1. What were the inadequacies of the common law which made necessary the enactment of workmen's compensation laws?
2. Trace the steps by which an injured employee secures compensation under a compensation act. Compare this procedure with the procedure by which an injured employee secured damages under the common law.
3. What in general is the basis of compensation under the compensation laws? Compare this with the basis of compensation under the common law.
4. The New York act provides that an employer must in one of several ways provide security for the payment compensation. What is the purpose of this provision? What security did an injured employee have under the common law?
5. It was contended that the law under consideration in the principal case is unconstitutional in that it imposes liability upon an employer when he is not at fault, thus depriving him of due process of law. How was this contention met?
6. It was contended that the law is unconstitutional because it interferes with freedom of contract. How was this contention met?
7. It was contended that the law is unconstitutional because it denies to the defendant the equal protection of the law. What was the basis of this contention? How was the contention met?
8. What is the difference between an elective compensation law and a compulsory compensation law?
9. Examine the statutes of some state in which you are interested and make a digest of the workmen's compensation act, if the state in question has such an act, covering the following points: (*a*) whether optional or compulsory; (*b*) employments covered; (*c*) basis of compensation; (*d*) compensation for death, for total disability, and for partial disability; (*e*) the period which the employee must wait for compensation; (*f*) whether an employer must furnish security for payment of compensation; (*g*) how the law is administered.

ii. COMPENSABLE INJURIES

YATES *v.* SOUTH KIRBY COLLIERIES

Law Reports 2 King's Bench Division 538 (1910)

In October, 1909, the applicant—a collier, forty-six years of age, who had been engaged in coal mining all his life, and for twenty-seven years had been working at the face of the coal in the pit belong-

ing to the respondents—while working as usual, heard a shout for help from the next working-place. He ran round his loose end at once and found a fellow-collier lying full length on the ground, having been knocked down by a fallen timber prop and some coal; he was bleeding all over his head and from his ears and eyes. The applicant picked him up in his arms and, with assistance, carried him away; he was not dead at the time, but died in a quarter of an hour. The effect on the applicant was such that he sustained a nervous shock, which incapacitated him from working at the coal face.

Proceedings for compensation having been taken, the county court judge found as a fact that there was genuine incapacity to work which was due to the nervous shock which he sustained in October, 1909, when it clearly was his duty to his employers to go to the assistance of the injured collier who shouted for help from the next working-place, and that his doing so arose both "in the course of" and "out of" his employment. The learned county judge accordingly awarded the applicant compensation at 19*s.* to the date of the award, and 10*s.* a week till further order.

The respondents appealed.

Farwell, L. J. It is rightly conceded that it was part of the man's duty to go to the assistance of his fellow-workman. Therefore, there is no question that the events arose "out of and in the course of the employment." The learned county court judge has found as a fact that there was a genuine incapacity to work, which was due to the nervous shock which the applicant sustained in October last. In my opinion nervous shock due to accident which causes personal incapacity to work is as much "personal injury by accident" as a broken leg, for the reasons already expressed by this court in the case of *Eaves* v. *Blaenclydach Colliery Co.* (1909), 2 K.B. 73. In truth I find it difficult, when medical evidence is that as a fact a workman is suffering from a known complaint arising from nervous shock, to draw any distinction between that case and the case of a broken limb. I see no distinction for this purpose between the case of the guard who is not in fact physically injured by an accident to his train, but who, after assisting to carry away the wounded and dead, breaks down from nervous shock, and the case of the guard who in similar circumstances stumbles over some of the débris and breaks his leg. The difficulty is to prove the fact so as to avoid the risk of malingering, but when the facts have been proved, the injury causing incapacity to work arises from the accident in the one case as in the

other. I am, therefore, of opinion that the judgment of the learned county court judge must be affirmed.

QUESTIONS

1. Would the master have been liable under the common law for the injury which the servant suffered in this case?
2. What is the danger involved in granting compensation in cases like the principal case?
3. P, while working near an open hatchway, was seized with a fit and fell through the hatchway. Is this an accident?
4. P, a fireman, working in a stokehole, drank water excessively, causing a hemorrhage. Is this an accident?
5. P, while engaged in D's employment, sustained a serious personal injury. P makes a claim for compensation. D sets up the following defenses: (*a*) that P assumed this particular risk; (*b*) that the injury was due to the negligence of a fellow-servant; (*c*) that the injury was the result of P's own negligence. What decision?
6. P is injured through his own wilful misconduct. Is this an accident within the meaning of compensation laws?

CLOVER, CLAYTON & COMPANY *v.* HUGHES

L.R. 1910 Appeal Cases 242

Lord Loreburn, L.C. My Lords, in this case a workman, suffering from an aneurism in so advanced a state of disease that it might have burst at any time, was tightening a nut with a spanner, when the strain, quite ordinary in this quite ordinary work, ruptured the aneurism and he died. This is a mere summary of the facts. They and the learned county court judge's conclusions from them are stated fully in his instructive judgment. In what I have to say I take the facts as he found them *in extenso* and rely upon them.

He has held, and the Court of Appeals have confirmed his decision, that in these circumstances the workman's dependents are entitled to compensation. I agree.

What, then, is an "accident"? It has been defined in this House as "an unlooked for mishap or an untoward event, which is not expected or designed." All the Lords who took part in the decision of *Fenton* v. *Thorley* (1903), A.C. 443, agreed in substance with this definition in Lord Macnaghten's speech. I take that as conclusive.

This man died from the rupture of an aneurism, and "the death was caused by a strain arising out of the ordinary work of the deceased operating upon a condition of body which was such as to render strain

fatal." Again, "the aneurism was in such an advanced condition that it might have burst while the man was asleep, and very slight exertion, or strain would have been sufficient to bring about a rupture." These are the findings and they bind us.

The first question here is whether or not the learned judge was entitled to regard the rupture as an "accident" within the meaning of this Act. In my opinion he was so entitled. Certainly it was an "untoward event." It was not designed. It was unexpected in what seems to me the relevant sense, namely, that a sensible man who knew the nature of the work would not have expected it. I cannot agree with the argument presented to your Lordships that you are to ask whether a doctor acquainted with the man's condition would have expected it. Were that the right view, then it would not be an accident if a man very liable to fainting fits fell in a faint from a ladder and hurt himself. No doubt the ordinary accident is associated with something external, the bursting of a boiler, or an explosion in a mine, for example. But it may be merely from the man's own miscalculation, such as tripping and falling. Or it may be due both to internal and external conditions, as if a seaman were to faint in the rigging and tumble into the sea. I think it may also be something going wrong with the human frame itself, such as the straining of a muscle or the breaking of a blood vessel. If that occurred when he was lifting a weight it would be properly described as an accident. So, I think, rupturing an aneurism when tightening a nut with a spanner may be regarded as an accident. It cannot be disputed that the fatal injury was in this case due to this accident, the rupture of the aneurism under the strain.

QUESTIONS

1. What was the test of an employer's liability for injuries to his employees under the common law?
2. Compensation laws typically provide that employers shall compensate their employees for "personal injuries by accidents arising out of and in the course of employment." What is the theory underlying this liability? What is the justification for imposing this character of liability on an employer?
3. What test does this court announce for determining whether a given injury is an "accident" within the meaning of the compensation laws?
4. Can it really be said that the death in the principal case was the result of an accident? Was the death not rather the result of the natural disintegration of the human system?

NISBET *v.* RAYNE & BURN

Law Reports 2 King's Bench Division 689 (1910)

FARWELL, L. J. The deceased man was a cashier in the employment of the appellants, who are colliery owners, and it was part of his duty to take the money necessary to pay the men's wages on the regular paydays to the colliery, and for this purpose to travel by rail to the colliery; and while he was thus engaged on March 18, 1910, he was robbed and murdered in the train. The question is whether he met his death by accident arising out of and in the course of his employment.

It is argued, first, that there was no "accident" at all, because death resulted from the intentional act of the murderer, and intention excludes any idea of accident. But the intention of the murderer is immaterial; so far as any intention on the part of the victim is concerned, his death was accidental; and although it is true that one would not in ordinary parlance say, for example, that Desdemona died by accident, this is because the horror of the crime dominates the imagination and compels the expression of the situation in terms relating to the crime and the criminal alone; and it would be quite natural to say that a man who died from the bite of a dog or the derailment of a train caused by malicious persons putting an obstacle on the line died by accident. But the point is covered by the decision in *Challis* v. *London & South Western Railway Co.* (1905), 2 K.B. 154, at page 156, where LORD COLLINS, then Master of the Rolls, says: "He"—that is, the county judge—"appears to me to have decided that, as the stone was wilfully dropped, it was an intentional act, and, therefore, there could not be said to have been an accident. I think that the judge was wrong in so holding. I do not think that there was anything in the fact that the stone was wilfully dropped to prevent what happened from being an accident from the standpoint of the person who suffered through it"; and by the Irish case of *Anderson* v. *Balfour* (1910), 2 I.R. 497.

QUESTIONS

1. What test does the court in this case announce for determining what is an accident?
2. How can an intentional wrong inflicted by a third person be properly designated as an accident?
3. X, a small boy, standing on an overhead bridge, mischievously threw a rock at a passing train and struck the engineer in the eye. Is this an accident?
4. P, nervous and depressed from overwork in his employment, commits suicide. Is this an accident?

BRINTONS *v.* TURVEY

L.R. 1905 Appeal Cases 230

The respondent's husband, while employed with other workmen in sorting wool in the appellant's factory, was infected with anthrax on the second of March, 1903, and died thereof on the seventh. In an arbitration, after hearing medical evidence, the county judge awarded compensation to the respondent. This decision was affirmed by the Court of Appeal.

Lord Macnaghten. My Lords, on the facts found by the learned county judge I am of opinion that the decision of the Court of Appeal was right. It is plain, I think, that the mischief which befell the workman in the present case was due to accident, or rather, I should say, to a chapter of accidents.

It was an accident that the noxious thing that settled on the man's face happened to be present in the materials which he was engaged in sorting. It was an accident that this noxious thing escaped the down draught or suck of the fan which the Board of Trade, as we were told, requires to be in use while work is going on in such a factory as that where the man was employed. It was an accident that the thing struck the man on a delicate and tender spot in the corner of the eye. It was through some accident that the poison found entrance into the man's system, for the judge finds that there was no abrasion about the eye, while the medical evidence seems to be that without some abrasion infection is hardly possible. The result was anthrax, and the end came speedily.

Speaking for myself, I cannot doubt that the man's death was attributable to personal injury by accident arising out of, and in the course of, his employment. The accidental character of the injury is not, I think, removed or displaced by the fact that, like many other accidental injuries, it set up a well-known disease, which was immediately the cause of death, and would no doubt be certified as such in the usual death certificate.

Lord Lindley. My Lords, I hope that the decision in this case will not be regarded as involving the doctrine that all diseases caught by a workman in the course of his employment are to be regarded as accidents within the meaning of the Workmen's Compensation Act. That is very far from being my view of the Act, and I concur with the observations made by Cozens-Hardy, L. J., on this point at the end of his judgment. In this case your Lordships have to deal with death resulting from disease caused by an injury which I am

myself unable to describe more accurately than by calling it purely accidental.

Order of Court of Appeal affirmed and appeal dismissed with costs.

QUESTIONS

1. Would the master have been liable under the common law for the injury which the servant suffered in this case? Why or why not?
2. P, while engaged in D's employment, contracted smallpox from a fellow-worker. Is this an accident?
3. P contracted typhoid fever as a result of impure drinking water furnished by his master. Is this an accident?
4. P contracted rheumatism due to the dampness of the place in which he worked. Is this an accident?
5. P, in the line of his work, sustained a broken rib. Due to his weakened condition, he became inflicted with tuberculosis. Is this an accident?

TERLECKI *v.* STRAUSS
85 New Jersey Law Reports 454 (1914)

Petition under Workmen's Compensation Act. Petitioner quit work at her machine shortly before noon, and was preparing to go home. She was combing particles of wool out of her hair, as was the custom of the girl employees. For this purpose she went to a passageway where a piece of looking glass had been placed against a post, thirty-two feet from her machine. It was a common practice of the girls, to the knowledge of the superintendent and overseer, to do as the petitioner did, and it was not forbidden. There was a "sink" room but no dressing-room on that floor of the factory. While the petitioner was combing her hair it was caught in the still moving machinery and she suffered serious damage.

SWAYZE, J. We have no doubt that the accident happened in the course of employment. It would be entirely too narrow a construction to limit the benefit of the statute to the time the workman is actually employed at his machine. He must have time to reach his machine and to get away from his employer's premises. In fact, it is a necessary implication of the contract of employment that the workman shall come to his work and shall leave with reasonable speed when the work is over. The preparation reasonably necessary for beginning work after the employer's premises are reached, and for leaving when the work is over, is a part of the employment. A workman is none the less in the course of employment because he is engaged

in changing his working clothes for his street clothes. In the present case, it was reasonably necessary that the petitioner should comb her hair and remove the particles before leaving the factory.

The judgment is affirmed.

QUESTIONS

1. P, passing through a crowded street on his way home from work, is struck by an automobile. He claims compensation. What decision?
2. P works in D's factory. While proceeding across D's factory premises on his way to work he is struck by an automobile. Is he entitled to compensation?
3. P, for his own convenience, is riding home in a truck of his employer. He is injured in a street collision. Is he entitled to compensation?
4. D, owner and operator of a mine, transports his employees to and from the mines, a distance of six miles, in trucks. P, one of D's employees, is injured in a wreck while being thus carried home. Is P entitled to compensation?
5. P, a gas inspector, while making his itinerancy, is injured in a street-car wreck. Is he entitled to compensation?
6. P, a servant, living on the premises of her employer, is suffocated by gas while sleeping in her room. Is she entitled to compensation?
7. P, while eating his lunch on the premises of his employer, is injured by an explosion of a boiler. Is he entitled to compensation?

WHITEHEAD *v.* READER

Law Reports 2 King's Bench Division 48 (1901)

The applicant was a carpenter, and a part of his duty was to sharpen his tools at a grindstone rotated by machinery. He had been forbidden to touch the machinery, but the band that rotated the grindstone came off, and he endeavored to replace it. In doing so he sustained an injury to his hand for which he sought to obtain compensation. The county court judge found that the accident that caused the injury arose out of and in the course of the employment of the workman, that he had been forbidden to touch the machinery, but that he had not been guilty of serious and wilful misconduct in endeavoring to replace the band. An award was made in favor of the applicant, and the employer appealed.

COLLINS, L. J. I agree in what has already been pointed out, that it is not every breach of a master's orders that would have the effect of terminating the servant's employment so as to excuse the master from the consequences of the breach of his orders. We have to get back to the orders emanating from the master to see what is the sphere

of employment of the workman, and it must be competent to the master to limit that sphere. If the servant acting within the sphere of his employment violates the order of his master, the latter is responsible. It is, however, obvious that a workman cannot travel out of the sphere of his employment without the order of his employer to do so; and if he does travel out of the sphere of his employment without such an order, his acts do not make the master liable either to the workman under the Workmen's Compensation Act, 1897, or to third persons at common law. Take as an illustration the case of *Beard* v. *London General Omnibus Co.* (1900), 2 Q.B. 530, in which the conductor of an omnibus took upon himself to drive it in breach of his master's orders, because his employment was limited by the master to acting as conductor, and it was not shown that he had authority to drive, an employment for which he might have been quite unfitted. In the present case, if the two spheres of employment had been distinctly separated and defined—namely, the grinding of the tools and the skilled labor of managing the machinery—and the applicant's employment had been limited to the former, and if, while acting in breach of the order limiting his employment, he had met with the accident, the master would not have been liable. The county court judge came to the conclusion that the injury to the workman arose from an accident in the course of the employment, and he coupled that with a finding as to that which the man did, not being serious and wilful misconduct, which does not show that the workman had traveled out of the sphere of his employment in doing that which resulted in the injury to him. The county court judge has not furnished to this court materials upon which we can say that he was wrong in law, and therefore this court is not in a position to differ from the conclusion at which he arrived.

QUESTIONS

1. The injury complained of in this case was the direct result of the servant's disobedience. Why then should he be entitled to compensation?
2. P was employed to oil certain machinery and was directed never to oil the machinery while in motion. He had at times done so when the mill was in motion and had been warned not to do so again. Later, oiling the machinery while in motion, he was caught in the machine and his arm was badly crushed. Is he entitled to compensation?
3. P, whose duty it was to walk behind a lorry, ready to apply the brakes when needed, in disobedience of his master's instructions, rode upon the lorry beside the driver and in getting off to apply the brakes fell and received an injury. Is he entitled to compensation?

4. P, while working as a machinist in D's plant, went to the assistance of a fellow-worker who had fallen into a vat of boiling water. P stumbled and himself fell into the water and was so badly scalded that he died. Are his dependents entitled to compensation?
5. P and certain fellow-workers, during their hours of employment, were scuffling, in the course of which P was thrown against moving machinery and seriously injured. Is he entitled to compensation?

GRIFFITH *v.* COLE BROTHERS

183 Iowa Reports 415 (1918)

SALINGER, J. The defendants were bridge builders, who had charge of construction of county bridges in Story County. Deceased was employed by them. Decedent and others in such employment were by defendants lodged and boarded on the ground where the work was done. On the night of the accident, the day's work had been finished, but the employees were in the boarding tent. They had got through washing the dishes, and were sitting there until it was time to go to bed. While thus engaged, the decedent came to his death from a stroke of lightning. Concede that he was in the course of his employment while thus in the tent awaiting bedtime, or supervising other employees in getting ready for bed, and still there must be proof that the injury arose out of such employment. The burden is on the claimant. It is not discharged by creating an equipoise. It requires a preponderance.

It must appear by a preponderance that there is some causative connection between the injury and something peculiar to the employment (*Jones* v. *United States Mutual Accident Association*, 92 Iowa 652); that it resulted from some risk reasonably incident to the employment, because "out of" involves the idea that the injury is in some sense due to the employment (*Fitzgerald* v. *W. G. Clarke & Son*, 2 K.B. [1908] 796); a causative danger peculiar to the work, and not "common to the neighborhood," an injury fairly traceable to the employment as a contributing cause—to some hazard other than one to which the workman would have been equally exposed though in a different employment (*McNicol's* case, 215 Mass. 497); a hazard peculiar to the business which is "the immediate cause" of the injury (*Rodger* v. *Paisley School Board*, 1 Scots Law Times [1912], 271); and injury due to something more than the normal risk to which all are subject, which, at least, means that the employment necessarily accentuates the natural hazard attendant upon work done in the course of the employment (*State* v. *District Court*, 129 Minn. 502).

The most that may be said where, as here, an employee is injured while sitting in his boarding tent, preparatory to going to bed, is that, if he had not been employed, he would not have been present in the tent and would not have been struck at the time he was. In the same sense, the fact that he was born establishes a causative connection. If he had never come into being, he could not have been struck by lightning. The same argument might be made for a claim against one who sold a carriage to one who was struck by lightning while riding in it. What was said in *Craske* v. *Wigan*, 2 B.W.C.C. 35, covers the situation:

It is not enough for the applicant to say "the accident would not have happened if I had not been engaged in this employment, or if I had not been in that particular place." The applicant must go further, and must say, "The accident arose because of something I was doing in the course of my employment, and because I was exposed by the nature of my employment to some peculiar danger."

In our opinion, the injury claimed for did not arise "out of" decedent's employment.

QUESTIONS

1. Was the claimant denied compensation in this case because the injury did not arise in his employment or because it did not arise out of his employment?
2. In view of the purpose of compensation legislation, what should be the test as to whether a given injury arises out of one's employment?
3. P, while operating a metal scraper on a highway, was struck by lightning. Is this a compensable injury?
4. P, while working on a scaffold some thirty feet high, was struck by lightning. Is this a compensable injury?
5. P, while working on a road, on a hot summer day, suffered a sunstroke. Is this a compensable injury?
6. P, a baker's driver, while delivering bread on a severely cold day, was badly frost-bitten. Is this a compensable injury?
7. P, a house servant, was sent to post a letter. In passing down the street, she slipped on a banana peel and sustained a serious injury. Is this a compensable injury?

CHALLIS *v.* LONDON AND SOUTHWESTERN RAILWAY

Law Reports 2 King's Bench Division 154 (1905)

Collins, M. R. This is an appeal from the ward of a county judge dismissing a claim for compensation made by the dependants of a deceased engine-driver. The circumstances were these. While the deceased was driving a train under a bridge, what is called the "eye-glass" of the driver's cab on the engine appears to have been broken by a stone, which the county judge finds to have been de-

liberately thrown by a boy standing on the bridge. The effect of the breaking of the glass was that the driver's face and eyes were injured. It has not been finally decided whether that injury was ultimately the cause of his death, because the county judge held that the injury was not caused by an accident arising out of the deceased's employment, and therefore it was not necessary to determine that question.

The contention was that this occurrence, though an accident, was not one which could be said to have arisen out of the deceased's employment. I do not think that, in deciding that question, we should be justified in leaving out of sight what is matter of common knowledge and experience in relation to the subject with which we are dealing; and therefore we must, I think, approach the question whether what occurred was a risk incidental to the employment of an engine-driver from the standpoint that a train in motion has great attractions for mischievous boys as an object at which to discharge missiles.

It seems to me that the Legislature, in framing the Workmen's Compensation Act, 1897, intended to provide for the risks of accident which are within the ordinary scope of the particular employment in which the workman is engaged. No doubt the Act does not use the expression "risks incidental to the employment"; but the interpretation of the words "accidents arising out of and in the course of the employment" appears to me necessarily to involve the consideration of the question what risks are commonly incidental to the particular employment in question. The cases relied upon by the respondents are not in my opinion inconsistent with the view that such an accident as occurred in the present case is within the Act. On the contrary, they appear to me to be rather in favor of that view. Take the case of *Armitage* v. *Lancashire & Yorkshire Railway Co.* (1902), 2 K.B. 178. It appears from the judgment in that case that, in dealing with the question whether the particular accident which had happened arose out of the employment, the test applied was whether it was within the scope of the employment of the workman to submit to the risk of such an accident; and in that case we held that, the accident not being one to the risk of which it was within the scope of his employment to submit, it did not come within the purview of the Workmen's Compensation Act, 1897. In the case of *Falconer* v. *London and Glasgoe Engineering and Iron Shipbuilding Co.*, 3 F. 564, the same test seems to have been applied by all the judges of Session in Scotland. In giving judgment, the Lord Justice-Clerk said: "It was against accidents incidental to the special employment that the benefit o

this statute was given." LORD TRAYNER said: "If some servants leave their work and indulge in horseplay to the injury of a fellow-servant, that does not infer liability on the employer. It cannot be said to be incidental to his business, or one of the hazards attached to it." In the present case such an accident as happened does appear to me to be one incidental to the employment and a hazard attached to it. LORD MONCRIEFF held that the particular accident in that case was one incidental to the employment, and therefore differed from the conclusion arrived at by the majority; but all the members of the Court appear to have concurred in the view that the object of the Workmen's Compensation Act, 1897, was to provide for those risks which are incidental to the particular employment in which the workman is engaged. For these reasons I think that, as a matter of law, upon the facts in this case there was an accident arising out of the deceased workman's employment; but, as the county judge has left undetermined the question whether the death of the workman resulted from that accident, the case must go back to him in order that he may decide that question.

QUESTIONS

1. P was employed by D, a greengrocer, as an errand boy. D was known to be subject to fits of melancholia and had been in an asylum. One day D attacked P with a chopper and seriously injured him. Is this a compensable injury?
2. P, a cashier in the employ of D, while carrying a large sum of money to D's mines with which to pay employees, was shot and robbed by some third person. Is this a compensable injury?
3. P, a potman, was cleaning a brass plate on the street side of D's public house when he was injured by a bomb from an enemy aircraft. Is this a compensable injury?
4. P was a strike-breaker in D's employ. When leaving the plant at the end of the day, P was assaulted by some striking employees. Is this a compensable injury?
5. P, a clerk in the employ of D, was assaulted by a disgruntled customer. Is this a compensable injury?
6. A dispute arose between P and X, fellow-workers in the employ of D, as to the mode of doing a certain piece of work. In the course of the controversy, X assaulted P. Is this a compensable injury?
7. P, a bill-collector in the employ of D, was bitten by a dog kept by a delinquent debtor on whom P was calling. Is this a compensable injury?
8. P, while engaged in threshing, was stung by a wasp, causing his death. Is this a compensable injury?
9. P, a maid, while engaged in her work, was sewing at an open window. A cockchafer flew into her face. She threw up her hand to protect herself and injured her eye with the needle. Is this a compensable injury?

CHAPTER III

COMPETITIVE LABOR PRACTICES

LUMLEY *v.* GYE

2 Ellis and Blackburn's Reports 216 (1853)
(Reprinted Volume I, *Law and Business*, p. 178)

QUESTIONS

1. What was the issue under consideration in the case of *Lumley* v. *Gye?* How was the issue decided? What rule of law can be deduced from the decision?
2. Does competition between rival employers justify one in knowingly inducing a breach of contract of employment by an employee of the other?
3. D, by offers of higher wages, induces ten men, employed by P under an arrangement terminable at the will of either party, to leave P and accept employment with him. To what relief, if any, is P entitled?
4. In the foregoing case D induces the men to leave P by publishing fraudulent misrepresentations concerning P. To what relief, if any, is P entitled?
5. P and D, rival employers, are seeking to employ X and others. D secures their services (*a*) by offers of higher wages, (*b*) by publishing false statements concerning P, and (*c*) by threats of violence. To what relief, if any, is P entitled?

THE MASTER STEVEDORES' ASSOCIATION *v.* WALSH

2 Daly's New York Reports 1 (1867)

This was a demurrer to the complaint, on the ground that it did not state facts sufficient to constitute a cause of action.

The plaintiffs are a corporation of which the defendant is a member, and is, as its name imports, an association of master stevedores. The association adopted a by-law or "pledge" to the effect that there should be no variations from the prices adopted by the association, and that if any member, after an investigation by a committee, should be found guilty of working for less than the prices fixed, he should forfeit to the association 25 per cent of the amount of such bill as fixed, which penalty might be collected in the name of the corporation by due process of law.

The complaint alleges that the by-law was subscribed to by the defendant, that the corporation had fixed the rate of discharging railroad iron from vessels at thirty-two cents a ton, and that the defendant discharged fifteen hundred tons in violation of this regulation; that he was consequently found guilty by the association of working for less than the recognized price, and incurred a penalty of $125, for the recovery of which the action is brought.

DALY, F. J. The complaint is demurred to upon the ground that no action lies upon the facts stated, the specific objection raised by the demurrer being that the by-law is illegal because the object it is designed to effect is one that is forbidden by law, and that no action can consequently be maintained upon it.

It is not, nor has it ever been, a rule of the common law that any mutual agreement among journeymen for the purpose of raising their wages is an indictable offense, or that they are guilty of a conspiracy if, by preconcert and arrangement, they refuse to work unless they receive an advance of wages. The Chief Justice admitted that he had found but few adjudications upon the subject, and that the offense of conspiracy had been left in greater uncertainty by the common law than most offenses. He remarked that precedents in the absence of adjudications were some evidence of what the law is, and he referred to several, but none of them warrant the conclusion that they were founded upon any rule of the common law. He referred to but two adjudged cases: *The King* v. *The Journeymen Tailors of Cambridge*, 8 Modern, 11, and *The Tub Women* v. *The Brewers of London*, the last of which cases, he says, has been cited as sound law by all subsequent criminal writers. There is no report of any case under such a name as *The Tub Women* v. *The Brewers of London*. It is merely mentioned by name in the case first above cited, as authority for the proposition that a conspiracy of any kind is illegal, though the matter about which the parties conspired might have been lawful for them, or any of them, to do, if they had not conspired to do it. The first volume of the *Modern Reports*, in which this reference is found, is one of the least reliable of the English reports, being full of inaccuracies, blunders, and misstatements. BURROWS, in his reports, speaks of it as a "miserable, bad book," and says, that upon being cited, the Court of King's Bench treated it with the contempt it deserved (1 Burr. 386; 3 *id.* 1326); and by an excellent authority upon the books of reports and their reporters, it is characterized by the epithet of *execrable* (Wallace's *Common Law Reports*, 3d ed.,

p. 226). The title, "*The Tub Women* v. *The Brewers of London*," is undoubtedly a mistake, and it has been conjectured that the case referred to is *The King* v. *Sterling and Others*, reported in 1 Lev. 125; 1 Sid. 274; 1 Keb. 350. I entertain no doubt but that this conjecture is correct, and a brief statement of that case will suffice to show what was determined by it. The defendants—brewers of London—were found guilty of a conspiracy for agreeing that they would brew no small beer, which was the drink of the poor, for a certain length of time, nor ale, except at a certain price, with the intent of moving the common people to pull down the excise-house and to bring the excisemen into public odium, that they might be impoverished and disabled from paying their rent to the government, to the diminution of the revenue; which was a very clear case of conspiracy, the design being to impair the public revenue, to inflict pecuniary injury upon all excisemen, and to stir up a public tumult. Assuming it to be, as I have no doubt it is, the case referred to under the supposititious title of the "*The Tub Women* v. *Brewers of London*," it would have been more correct to have said that it warrants the conclusion that though the brewers, or any of them, had the right to cease brewing, or to raise the price of their ale, it was unlawful for them to combine to do so for such an object as the one above stated. The case is an authority simply for a familiar principle of the criminal law, that it is a conspiracy to combine to do a lawful act for an unlawful purpose, or by unlawful means.

As respects the remaining case (*The King* v. *The Journeymen Tailors of Cambridge*), it is also found in this discredited volume of reports, in further condemnation of which I may cite the remark of an eminent English judge, JUSTICE WILMOT, that, "nine cases out of ten in this book are totally mistaken" (*The King* v. *Harris*, 7 Term R. 238). But even the case, as reported there, affords no ground for the inference that there was any such rule at the common law as CHIEF JUSTICE SAVAGE supposed. In 1721, when the case was decided, there were acts of Parliament regulating the rate of wages. The defendants, according to the report, were indicted for refusing to work unless they received higher rates than the statute allowed. And, as far as can be gathered from the confused statement of the reporter, the conviction was held to be good, because they had conspired to raise their wages beyond what the law permitted. These early English statutes, regulating the price of labor, being wholly inapplicable to us in our colonial condition, were never in force in this country,

and formed no part of the law of the Colony of New York, at the adoption of our State Constitution in 1777. This decision, therefore, was limited to England, deriving its whole effect from the English statute, the provisions of which it was held that defendants had conspired to defeat.

Chief Justice Gibson declared in 1821, that it had never been decided in England that it was unlawful for journeymen to agree that they would not work, except for certain wages, or for master workmen to agree that they would not employ any journeymen, except at certain rates (*Commonwealth* v. *Carlisle*, Hall's *Journal of Jurisprudence for 1822*, I, 225). And in corroboration of the statement of this very accurate and eminent jurist, I would add that I have examined down to the present time, and have found no case, either in this country or in England, in which any such decision has been rendered.

In the *Commonwealth* v. *Hunt* (4 Metc. 111), Chief Justice Shaw considered this question, and laid down the broad proposition that men are free to work for whom they please, or not to work if they so prefer, and that it is not criminal for them to agree together to exercise this right in such a manner as may best subserve their own interest; and in the case of the *Hartford Carpet Weavers*, tried before the Superior Court in Connecticut, in 1836, printed at Hartford, 1836, Chief Justice Williams told the jury that if the real nature of the agreement between the defendants was an agreement not to work below certain prices, that that was not an indictable offense, nor the subject of a civil action; that it had been so determined in that court, and under this ruling the defendants were acquited. The case is entitled to great weight. It was the third trial. A great deal of time was given to it, more than seventy witnesses having been examined. It was elaborately argued by counsel, and the ruling of the Chief Justice was made after the case had been considered upon appeal.

The distinction which this statute (Act of 5 Geo. IV. c. 95), makes between the legality of associations among workmen for the protection of their interests, by agreeing as a body not to work below certain prices, and an illegal combination formed for the purpose of making it compulsory upon all journeymen in a particular branch of business, and upon the employers, to conform to certain prices by imposing penalties upon the journeymen in a city or town who refuse to do so, or by agreeing as a body not to work for any employer who

will employ such a journeyman, or one who will not pay the penalty or become a member of the combination, or which seeks to accomplish such a purpose by violence, intimidation, or other unlawful means, is one that has been slowly arrived at in England, and toward which the courts in this country have been gradually approximating, for the reason that it has its foundation in the plainest principles of justice. The apprehension that if this be conceded it would place employers wholly at the mercy of their workmen, who would have it in their power to exact any sum for their services, however extravagant, is altogether an imaginary one. It is not possible by any organization among journeymen to bring about such a result. The history of English legislation upon the subject of wages, and of the operations of trades unions, shows that it is neither in the power of prohibitory laws nor of artificial combinations to control arbitrarily the price of labor, and that no combination can devise any general regulation or scheme that will bring to the same level the skilful and the incompetent, the diligent and the idle. All such matters regulate themselves. If labor is in demand, the rate of compensation will be enhanced in proportion; and if it is not, no combination among workmen can prevent the falling of prices. Voluntary associations among workmen, or agreements among them not to work except for certain prices, are effectual only when their demands are just and reasonable, and when they attempt anything more, they not only fail of their object, but are themselves the chief sufferers. Workmen in every branch or calling are too universally diffused to depend upon their necessities, and too diverse in their interests to make it possible by organization to accomplish anything beyond this, for if those in any one place ask what is exceptionable or unreasonable, by the natural law of demand and supply others will come in and take their places.

But it may be in their power to secure by associated effort what it would not be possible for any one of them to accomplish alone; and that they should have the right to associate together for the mutual protection of their individual interest is so plain, that it is singular that it should ever have been questioned. Journeymen may be as well acquainted as their employers with the causes which affect the price of labor, and in this country are generally well informed in such matters. They may be quite as well able to judge whether the ordinary profits of employers justify a reduction or an increase in the rate of wages. Why, then, should they not have the right to come together to consider the condition of the branch of industry in

which they are operatives, to impart information to each other, to exchange their views, and discuss in a body a matter in which they are so deeply interested? Merchants meet daily upon 'Change that they may be thoroughly informed upon all matters relating to the traffic in which they are engaged; and why should not journeymen meet together to consider and act upon a subject so important to them as the general rate of wages? The exact sum which should be required for a day's wages may be fluctuating and uncertain through the operation of other causes than those of demand and supply, such as the instability of the currency, by which the value of the paper representative of a dollar changes as the circulating medium is increased or diminished. These are matters for the consideration of workmen as well as all other causes affecting the price of their labor; and if they come together, and as the result of their deliberations conclude that a certain rate would be just and reasonable, and that they will not work for less, it would be the height of injustice to call such an act a crime, by declaring that it was, in the language of the statute, unlawfully conspiring to commit an act injurious to trade or commerce for which each of them may be indicted and punished.

It is better for the law to leave such matters to the action of the parties interested—to leave master workmen or journeymen free to form what associations they please in relation to the rate of compensation, so long as they are voluntary. They mutually act upon each other. If the workmen demand too much, or the masters offer too little, such a state of things cannot continue long, or be productive of any serious inconvenience to the community, as that party must ultimately give way whose pretensions are not founded in reason and justice (*Regina* v. *Harris*, 1 Carr. and Marsh. 662). It is otherwise, however, where organizations are formed to intimidate employers, or to coerce other journeymen; and it matters little what are the measures adopted, if the object of them is to interfere with the rights or to control the free action of others. It was held, under the English statute I have referred to, that it did not authorize workmen to combine for the purpose of dictating to a master whom he should employ (*Rex* v. *Rykerdyke*, 1 M. and Kobs, 179); and the several convictions in this country have been in cases where coercive measures were resorted to, either to prevent master workmen from employing journeymen except at certain rates, or to intimidate journeymen from engaging below such rates, or to compel them to become mem-

bers of the combination. Every man has the right to fix the price of his own labor—to work for whom he pleases, and for any sum he thinks proper; and every master workman has equally the right to determine for himself whom he will employ and what wages he will pay. Any attempt by force, threat, intimidation, or other coercive means to control a man in the fair and lawful exercise of these rights is therefore an act of oppression, and any combination for such a purpose is a conspiracy.

It may, therefore, be laid down as the result of this examination, that it is lawful for any number of journeymen or master workmen to agree on the one part that they will not work below certain rates, or on the other that they will not pay above certain prices; but that any association or combination for the purpose of compelling journeymen or employers to conform to any rules, regulation, or agreement fixing the rate of wages, to which they are not parties, by the imposition of penalties, by agreeing to quit the service of any employer who employs a journeyman below certain rates, unless the journeyman pays the penalty imposed by the combination, or by menaces, threats, or intimidations, violence or other unlawful means, is a conspiracy for which the parties entering into it may be indicted.

The demurrer must be overruled.

QUESTIONS

1. What was a conspiracy under the common law? Was it a criminal offense? Was there any civil liability for a conspiracy?
2. What were the means used in the principal case to establish the end sought? Were these means fair and reasonable?
3. Suppose that the organization had used fraud, defamation, violence, or threats of them to establish the end in view, what would have been the decision of the court?
4. What was the end sought by the defendant in this case? Was the end sought legitimate?
5. By what standard or standards are the legitimacy of the purposes of an organization to be determined? Who determines these standards?

KEMP *v.* DIVISION NO. 241

255 Illinois Reports 213 (1912)

This was a bill filed by certain employees of the Chicago Railways Co. against Division 241 of the Amalgamated Association of Street and Electric Railway Employees of America, the corporation, the officers, and members of its executive board. Its purpose was

to obtain an injunction restraining the appellants, the agents, and servants from attempting to secure the discharge of the appellees from the service of the Chicago Railways Co. because the appellees were not members of the said Division 241.

The Circuit Court of Cook County sustained a demurrer to the bill. The appellees prosecuted a bill to the Appellate Court where the decree sustaining the demurrer was overruled. The Appellate Court granted a certificate of importance and the appellants prosecute this appeal to the Supreme Court.

COOKE, J. The only reasonable conclusion to be deduced from the allegations and prayer of the bill is that appellees by this proceeding seek to restrain the union and its officers from calling a strike of its members, the obvious purpose of the injunction sought being to prevent the union employees of the railways company from quitting their employment in accordance with the vote previously taken by which those employees, as members of the union, declared that they would "cease to work with men who after receiving benefits through our organization refuse to continue members," appellees belonging to the class of men with which the union employees had thus declared they would no longer work. The question presented for our determination therefore is whether a court of equity is authorized upon application by the non-union employees to restrain a union and its officers from calling a strike of the union employees in accordance with the vote previously taken by the union employees as members of the union, where the purpose of the proposed strike is to compel the employer to discharge the non-union employees who are engaged in the same class of work. In order to decide this question in the affirmative it would be necessary to hold that had the threatened act been completed, appellees would have been entitled to maintain an action for damages against the union and its offices for accomplishing their discharge from the service of the railways company, and that such action at law would not afford an adequate remedy because of the financial inability of appellants to respond in adequate damages for the injuries which appellees would suffer by reason of their discharge. The inadequacy of the remedy at law sufficiently appears from the bill, and it will only be necessary to determine whether the appellees would have been entitled to maintain the action for damages had their discharge been accomplished by appellants.

That appellees would sustain damages if discharged by the railways company, and that such discharge and consequent damages

would be occasioned by the acts of the appellants, acting for and on behalf of the union employees, clearly appears from the bill. The mere fact that one person sustains damage by reason of some act of another is not, however, sufficient to render the latter liable to an action by the former for such damage, but it must further appear that the act which occasioned the damage was a wrongful act and not one performed in the exercise of a legal right, otherwise it is *damnum absque injuria*. In Cooley on *Torts*, at page 81, it is said:

> It is *damnum absque injuria*, also, if through the lawful and proper exercise by one man of his own rights a damage is caused to another, even though he might have anticipated the result and avoided it. That which it is right and lawful for one man to do cannot furnish the foundation for an action in favor of another. Nor can the absence of commendable motive on the part of the party exercising his rights be the legal substitute or equivalent for the thing amiss, which is one of the necessary elements of a wrong.

Again, on page 688 of the same work it is said:

> What was said in the opening chapter of the work, that the exercise by one man of his legal right cannot be a legal wrong to another, has been abundantly shown to be justified by the authorities, even if it were not, in itself, a mere truism. To state the point in a few words: whatever one has a right to do, another can have no right to complain of.

Every employee has a right to protection in his employment from the wrongful and malicious interference of another resulting in damage to the employee, but if such interference is but the consequence of the exercise of some legal right by another it is not wrongful, and cannot, therefore, be made the basis for an action to recover the consequent damages. It is the right of every workman, for any reason which may seem sufficient to him, or for no reason, to quit the service of another, unless bound by contract. This right cannot be abridged or taken away by any act of the legislature, nor is it subject to any control by the courts, it being guaranteed by the Thirteenth Amendment to the Federal Constitution, which declares that involuntary servitude, except as a punishment for crime, shall not exist within the United States or any place subject to their jurisdiction. Incident to this constitutional right is the right of every workman to refuse to work with any co-employee who is for any reason objectionable to him, provided his refusal does not violate his contract with his employer, and there is no more foundation for the contention that the employee commits an actionable wrong by informing the employer

before he leaves the service, that he will not work with the objectionable co-employee, and thereby occasioning his discharge, than there would be for the contention that the employee would commit an actionable wrong by quitting the service and afterward stating to the employer his reason therefor, if as a result thereof the employer should choose to discharge the objectionable co-employee. In either case the employee is exercising a legal right, and although it results in damage to the objectionable co-employee, the latter has no cause of action against the former for causing his discharge. In the case at bar, had the union employees as individuals and without any prearranged concert of action, each informed the railways company that they would no longer work with appellees because appellees were not members of the union, and had appellees, in consequence thereof, been discharged because the railways company chose to retain the services of the union employees, appellees would have no cause of action against the union employees for thus causing their discharge. Does the fact that the union, its officers and committees, acted as an intermediary between the union employees and the railways company, and under the circumstances and for the purposes disclosed by the bill, render unlawful the action by it or them which would have been lawful if performed by the union employees individually?

Labor unions have long since been recognized by the courts of this country as a legitimate part of the industrial system of this nation. The ultimate purpose of such organizations is, through combination, to advance the interests of the members by obtaining for them adequate compensation for their labor, and it has been frequently decided by the American courts that the fact that this purpose is sought to be obtained through combination or concerted action of employees does not render the means unlawful. In *Franklin Union* v. *People*, 220 Ill. 355, we said:

> It will be readily conceded by all that labor has the right to organize as well as capital, and that the members of Franklin Union No. 4 (being a labor union) had the same legal right to organize said union as the members of the Chicago Typothetae (being an association of employers) had to form that association, and that the members of Franklin Union No. 4 had the legal right to quit the employment, either singly or in a body, of the members of said association, with or without cause, if they saw fit, without rendering themselves amendable to the charge of conspiracy, and that the courts would not have been authorized to enjoin them from so doing even though their leaving the employment of the members of the association involved a breach of a contract.

Again, in *Wilson* v. *Hey*, 232 Ill. 389, we said: "The right of laboring people to organize for the purpose of promoting their common welfare by lawful means is fully recognized."

The purpose of organizing labor unions is to enable those employees who become members to negotiate matters arising between them and their employers through the intermediation of officers and committees of the union and to accomplish their ends through concerted action. If duly authorized by the employees to adjust any controversy arising between them and their employer, the union, its officers, and committees are merely acting as agents of the employees in the matter. If the union employees had the legal right to inform their employer of their refusal to work with appellees, they had the legal right to convey that information to the employer through an agent or agents, and the agent or agents would not commit an actionable wrong thereby nor by reporting back to the union employees the result of the conference with the employer. The demand that appellees be discharged, and the threat that unless the railways company complied with the demands the members of the union would call a strike of the employees of the railways company, in effect, meant no more than the mere statement that the union employees of the railways company would no longer work with the non-union employees, and if the railways company chose to retain in its employ the non-union men the union employees would quit the service of the railways company.

A strike is "the act of a party of workmen employed by the same master in stopping work all together at a preconcerted time, and refusing to continue until higher wages or shorter time, or some other concession, is granted to them by the employer" (Blacks's *Law Dictionary*). It is "a combined effort of workmen to obtain higher wages or other concessions from their employers by stopping work at a preconcerted time" (Bouvier's *Law Dictionary*). The threat made by the committee that the members of the union would call a strike of the employees of the railways company unless their demands were complied with meant no more than that the union employees would be notified to quit work in a body at a definite time if the non-union employees were retained in the service. This action of the committee, if not then authorized, was ratified by an almost unanimous vote of the union employees, and the union employees thereby authorized and instructed the union, its officers, and members to call the strike which it is sought by this proceeding to prevent. The

contemplated action of the union employees is not the result of the dictation of any officer or officers of the union or of any person not interested in the employment, but is the voluntary action of the union employees of the railways company. The threatened act of the union and its members is therefore, in effect, the act of the union employees themselves, and if those employees have the right to perform the act by concerted action and for the purposes alleged, their authorized agents commit no actionable wrong in the performance thereof.

As has been pointed out, had the union employees, as individuals and without prearrangement, each informed the railways company that they would no longer work with appellees, and had the employer voluntarily chosen to discharge appellees rather than lose the services of the union employees, they would have no cause of action against the union employees. No contract rights being involved, the union employees had a right to quit the service of the railways company, either singly or in a body, for any reason they chose or for no reason at all. If the only purpose of the union employees was to quit the service and permanently sever their connections with their employer, appellees would in nowise be damaged and could have no grounds for injunctive relief. The bill discloses, however, that this was not the only purpose of the members of the union. They did not purpose absolutely to sever their connection with their employer, but by means of a strike to withdraw temporarily their services, and then, by such means as might be proper and permissible, seek to induce their employer to accede to their demands and reinstate them in the service under the conditions they sought to impose. By thus combining it becomes necessary to inquire whether the purpose of the combination was a lawful one.

Ordinarily it is true that what one individual may rightfully do he may do in combination with others. In some jurisdictions the question of the purpose or motive in such cases as this is not inquired into. But in other jurisdictions the opposite view is held, for the very apparent reason that acts done by a combination of individuals may be made much more potent and effective than the same acts done by an individual, and we believe the greater weight of authority to be that what one individual may lawfully do a combination of individuals has the same right to do, provided they have no unlawful purpose in view. Would the calling of a strike, and the inducing of an employer thereby to accede to the demands of the union employees and to discharge appellees under the circumstances disclosed, be such

an interference with the rights of appellees as to be wrongful and malicious?

While it cannot be successfully contended that every strike is lawful, it is generally conceded by our courts that workmen may quit in a body, or strike, in order to maintain wages, secure advancement in wages, procure shorter hours of employment, or attain any other legitimate object. An agreement by a combination of individuals to strike or quit work for the purpose of advancing their own interests or the interests of the union of which they are members and not having for its primary object the purpose of injuring others in their business or employment is lawful. As to whether the object which this bill discloses was sought to be attained by the members of the union was a lawful one or a valid justification of the threat to strike, the authorities in this country are clearly in conflict. Among the cases in other jurisdictions upon which appellees rely in support of their contentions on this point are *Berry* v. *Donovan*, 188 Mass. 353, *Erdman* v. *Mitchell*, 207 Pa. 79, *Lucke* v. *Clothing Cutters*, 77 Md. 396. *Plant* v. *Woods*, 176 Mass. 492, and *Curran* v. *Galen*, 152 N.Y. 33. That some of the cases cited by appellees support their contention cannot be denied. A contrary result has been reached, however, by the courts of some of the other states. This precise question has never been passed upon in this state, and were the position of appellees to be sustained it would be a long step in advance of any decision of this court. In the unsettled condition of the law on this question we are not disposed to follow the cases cited by appellees. We are of the opinion that the cases holding the contrary view are supported by the better reasoning.

It does not follow from a consideration of all the material allegations of the bill that the primary object of the union employees, or of the union officers in carrying out the wishes of the members, was to injure appellees. Neither can it be said that any actual malice has been disclosed toward the appellees or an intent to commit a wrongful or harmful act against them. No threats are made and no violence is threatened. The members of the union have simply said to their employer that they will not longer work with men who are not members of their organization, and that they will withdraw from their employment and use such proper means as they may to secure employment under the desired conditions. While this is not a combination on the part of the union employees to maintain their present scale of wages, to secure an advance in the rate of wages or to procure

shorter hours of employment, all of which have been universally held to be proper and lawful objects of a strike, it cannot be said that this is not a demand for better conditions and a legitimate object for them to seek to attain by means of a strike.

It is insisted that a strike is lawful only in case of direct competition, and as it cannot be said that the union employees are in any sense competing with appellees, their acts cannot be justified. It is true, as has been stated, that the proposed strike was not to be called for the direct purpose of securing better wages or shorter hours or to prevent a reduction of wages, any one of which would have been a proper object. The motive was more remote than that, but it was kindred to it. The purpose was to strengthen and preserve the organization itself. Without organization the workmen would be utterly unable to make a successful effort to maintain or increase their wages or to enforce such demands as have been held to be proper. The following view expressed by Mr. Chief Justice Holmes in his dissenting opinion in *Plant* v. *Woods*, *supra*, in discussing facts similar to those here involved, is in our opinion a correct statement of the law and is applicable here.

> That purpose was not directly concerned with wages. It was one degree more remote. The immediate object and motive was to strengthen the defendants' society as a preliminary and means to enable it to make a better fight on questions of wages or other matters of clashing interests. I differ from my brethren in thinking that the threats were as lawful for this preliminary purpose as for the final one to which strengthening the union was a means. I think that unity of organization is necessary to make the contest of labor effectual, and that societies of laborers lawfully may employ in their preparation the means which they might use in the final contest.

If it is proper for workmen to organize themselves into such combinations as labor unions, it must necessarily follow that it is proper for them to adopt any proper means to preserve that organization. If the securing of the closed shop is deemed by the members of a labor union of the utmost importance and necessary for the preservation of their organization, through which, alone, they have been enabled to secure better wages and better working conditions, and if to secure that is the primary object of the threat to strike, even though in the successful prosecution of the object of the combination injury may result incidentally to non-union men through the loss of their positions, that object does not become unlawful. It is apparent that in this case the sole purpose was to insure employment by the

railways company of union men, only. The appellees had the right to retain their membership in the union or not, as they saw fit. On the other hand, if the members of the union honestly believed that it was to their best interests to be engaged in the same employment with union men only, and that it was a detriment and a menace to their organization to associate in the same employment with non-members, it was their right to inform the common employer that they would withdraw from its service and strike unless members of the union, only, were employed, even though an acquiescence in their demands would incidentally result in the loss of employment on the part of the non-union men. It was only incumbent upon them to act in a peaceful and lawful manner in carrying out their plans. In passing upon this question the court, in *Jersey City Printing Co.* v. *Cassidy*, 63 N.J. Eq. 759, says: "Union workmen who inform their employer that they will strike if he refuses to discharge all non-union workmen in his employ are acting within their absolute right, and, in fact, are merely dictating the terms upon which they will be employed." This case was approved in *Booth Brothers* v. *Burgess*, 72 N.J. Eq. 181. These cases hold that motive is not to be considered, and that the settled American doctrine, apart from all recent statutes, is, that all dealers in the market, whether in merchandise or in labor, on every side of the market, have an absolute right to combine voluntarily to concurrently exercise their several rights to refrain from contracting if they see fit to do so, and that if this is not good law, then the right to refrain from contracting is subject to a most extraordinary limitation, which leads to absurd results. The Supreme Court of Minnesota has said: "The authorities, as already noted, very generally hold that a strike is not unlawful; that members of labor unions may singly or in a body quit the service of their employer, and for the purpose of strengthening their association may persuade and induce others in the same occupation to join their union, and as a means to that end refuse to allow their members to work in places where non-union labor is employed." *Gray* v. *Building Trades Council*, 91 Minn. 171.

The judgment of the Appellate Court is reversed and the decree of the circuit court is affirmed.

Judgment reversed.

QUESTIONS

1. What was the end sought by the defendants in this case? Was it a legitimate end? What means were used to accomplish this end? Were the means used fair and reasonable?

2. What would have been the decision of the court if the defendants, after striking, had used fraud, defamation, intimidation, or coercion to secure the discharge of the complainants?
3. D and others are working for P under an arrangement terminable at the will of either party. They quit work in a body because P refuses to pay them higher wages. What are the rights of P, if any, under the circumstances?
4. D and others quit work in a body because P will not discharge X, an unpopular foreman. (*a*) What are the rights of P, if any? (*b*) What are the rights of X, if any?
5. D *et al.* strike because P refuses to deal with them through Y, not an employee of P, their representative. Discuss the legality of the strike.
6. D *et al.* strike to secure the discharge by P of all non-union workers. (*a*) What are the rights of P against D *et al.*? (*b*) What are the rights of the non-union workers against D *et al.*?
7. Would the decision in this case have been the same if the defendants had refused to receive the complainants into their union?
8. D *et al.* strike not because they have a controversy with P but because P will not accede to the demands of X *et al.* for higher wages. Discuss the legality of the strike.
9. P, a non-union carpenter, is employed by X in the construction of a building. D *et al.*, members of a plumbers' union, working on the same building, threaten to strike because X will not discharge P. D *et al.* harbor no ill will toward P nor do they have any particular person in mind to take P's place, but make the threat for the cause of organized labor. Discuss the legality of D's conduct.

EVERETT WADDEY COMPANY *v.* RICHMOND TYPOGRAPHICAL UNION

105 Virginia Reports 188 (1906)

This appeal arises out of a litigation between the appellants, complainants below, members of the unincorporated association known as the Richmond Typothetae, which is a branch of the United Typothetae of America, the membership of which are engaged in the business of printing; and the appellees, defendants below, are members of the Richmond Typographical Union No. 90, a branch of the International Typographical Union, also an unincorporated association, composed of a large majority of the employees of the employing printers of the United States. The main object of the first-named association is to protect and advance the interests of its members by uniting their strength; while that of the second-named association is to secure for its members better terms of employment.

In September, 1905, upon a refusal of the complainants to grant the demand of the defendants for an eight-hour working day, the defendants went out on a strike. The complainants brought this bill asking that the defendants be enjoined from illegally interfering with and molesting the complainants in their business. There was a decree in favor of the defendants in the court below. The complainants appealed.

CARDWELL, J. It seems to be conceded, in accordance with a long line of decisions, that if the allegations of the bill in this case are sustained by the proof, it is a case for equity jurisdiction, and the remedy is by injunction, since complainants' remedy at law would be inadequate. *Beck* v. *Railway Teamsters' Protective Union* (Mich.), 77 N.W. 13; *Miller* v. *Wills*, 95 Va. 327.

It is now well settled by the decisions of the courts of the United States and of the highest courts of a majority of the states in the Union that labor may organize as capital does for its own protection and to further the interests of the laboring class. They may "strike" and persuade and induce others to join them, but when they resort to unlawful means to cause injury to others to whom they have no relation, contractual or otherwise, the limit permitted by law is passed and they may be restrained. *Gray* v. *Trades Council* (Minn.), 97 N.W. 663, 63 L.R.A. 753, 103 Am. St. Rep. 477, and cases there cited; *Plant* v. *Woods*, 176 Mass. 492.

In many of the states of the Union there are statutes which provide for the incorporation of trades unions and other labor organizations, and in all of them one of the permissible objects of incorporation is declared to be the securement of better terms of employment; while at common law, as interpreted by the English decisions and a few of the earliest decisions of the courts in this country, labor combinations formed for the purpose of controlling the rate of wages were regarded as a criminal conspiracy. But these early decisions of the courts of this country were soon departed from by other cases, notably in Massachusetts, New York, and Pennsylvania, which placed labor combinations upon a place of legal equality with capitalistic combinations by holding that it was not a criminal conspiracy for workmen to combine for the purpose of enhancing the rate of wages, or for improving, in any other way, their relations with employers.

In *American and English Encyclopedia of Law*, XVIII (2d ed.), 87, it is stated to be the law, citing a number of decided cases, that: "It is not unlawful for strikers, by persuasion, to cause

employees to leave the service of their employer, or to dissuade other workmen from seeking employment with him."

But on the other hand it is fully as well settled that while "strikers" have the right to argue or discuss with new employees who have taken their places the question whether they should work for the employer and the right to persuade new employees not to do so, if they can, in presenting the matter they have no right to use force or violence, nor to terrorize or intimidate the new employees. *Union Pacific Railway Co.* v. *Reuff*, 120 Fed. Rep. 102.

In Eddy on *Combinations*, Vol. II, section 1031, the author says: "Where there is no sufficient evidence of violence, force, intimidation, or coercion, and the facts simply show that the parties complained of are persuading workmen still employed to quit their employment, and others, about to accept employment, not to do so, and that the persuasion consists of arguments, personal appeals, and inducements by way of payment of traveling expenses to other localities, an injunction will not be granted."

The gravamen of the complaint made by complainants is that by bribery, intimidation, and coercion of their employees by defendants they are being molested, annoyed, and irreparably damaged in their business. They claim that the bribery charged consisted of the payment of weekly benefits and transportation to their new employees by defendants' union, and the payment directly to one William Wilde, an employee of one of the complainants, the sum of $140 to leave, not only his employment, but the city of Richmond.

Bribery is not only unlawful, but criminal, and when resorted to with a malicious purpose to injure a third party in his business, property, or personal liberty, it would unquestionably afford ground for equitable interposition by injunction, if practiced in such a manner and to such extent that the party injured, or intended to be injured, could not obtain an adequate remedy at law for his injuries; but we have not been cited to any case, nor have we been able to find a case, which holds that the payment of weekly benefits or transportation, etc., to members of a labor union is *per se* bribery. It is the rule of such unions to pay weekly benefits, transportation, etc., to members, and that when a person becomes a member of the union he also becomes entitled to these benefits. It seems to have been the rule of the union, as old as the union itself, and was therefore not put in force because of this strike. It is, of course, one of the inducements held out to non-members to become members of the union, and is

doubtless used as one of the arguments to induce persons to join the union, and it is the rule governing like associations, such as secret orders, beneficial societies, etc., and we have seen it nowhere questioned that such union or society has the right to make and carry out such a rule in the government and control of the union or society. When one becomes a member of such a union he becomes entitled to the benefits given by the union, and if he receives any of them the giving or taking of such benefits clearly could not be characterized as bribery.[1]

The evidence, we think, fails to make a case showing that defendants have in any way so molested, annoyed, or damaged the complainants in the conduct of their business as to entitle them to the extraordinary relief by injunction.

Affirmed.

QUESTIONS

1. D *et al.*, employees of P, are on a strike for higher wages. (*a*) Through representatives, they are persuading and attempting to persuade other employees of P to join them in the strike. (*b*) They are dissuading prospective employees from accepting employment from P. What are the rights of P, if any, under the circumstances?
2. D *et al.* induce other employees to join the strike by promising to receive them into the union and to give them strike benefits. Discuss the legality of D's conduct.
3. D *et al.* dissuade prospective employees from accepting employment with P by furnishing them with transportation to other cities where employment can be secured. P asks that D *et al.* be enjoined from continuing such practices. What decision?
4. D *et al.* induce X to leave P's employment by an offer to pay him $500, not as a strike benefit nor as money for transportation, but simply as a gift. Discuss the legality of D's conduct.
5. D *et al.*, by misrepresentations and defamatory statements concerning P, dissuade prospective employees from accepting employment from P. What are the rights of P, if any, against D *et al.*?

[1] The discussion of the question, whether the payment of $140 to William Wilde to induce him to leave complainants' employ and the city of Richmond was illegal, is omitted. The court summarized the discussion in these words: "This plan of Wilde to obtain money from the union is shown to have been known to one or more of the complainants, and under these circumstances, and considering the conflicting and contradictory features of the affidavits he has made, and the admissions of bad faith he also makes, we take the view, as did the learned judge below, that his statements are entitled to little or no consideration in the determination of this controversy."

JONES *v.* VAN WINKLE GIN AND MACHINE WORKS

131 Georgia Reports 336 (1908)

EVANS, P. J. The Van Winkle Gin and Machine Works, a corporation, brought this action against the Atlanta Lodge No. 1, of the International Association of Machinists, an unincorporated body, and certain members thereof, who had lately been in the employment of the plaintiff, but who were on a strike, to enjoin them from picketing, intimidating, and otherwise interfering with the plaintiff's employees and business. The defendants showed cause against the grant of an injunction, both by demurrer and answer. After hearing evidence the defendants were "enjoined from placing themselves, their agents, or confederates, near the approaches to the petitioner's premises described in the petition and adjoining thereto, to induce persons working for petitioner not to work for it, and persons seeking employment by petitioner not to enter petitioner's employment, by threats of violence, intimidation, or persuasion, until the further order of the court." Exception is taken to the judgment in its entirety, and especially to so much thereof as forbids the defendants from placing themselves in or near the premises of the plaintiff for the purpose of persuading persons not to enter the plaintiff's employment, or to quit the same, so long as the entrances to the plaintiff's premises were not obstructed, and so long as violence, force, and intimidation were not used. The points raised by the demurrer were not argued in the brief, but only the legality of the decree and the sufficiency of the evidence to support it.

The lawfulness or unlawfulness of "picketing" has been the subject-matter of discussion in a large number of cases in this country. In the absence of statutes, courts have drawn from the elemental principles of the common law certain standards by which this modern factor used by labor unions as a means of settling controversies between employer and employees must be regulated. Every individual has a natural right to pursue a lawful occupation, and to conduct his business according to his own plans and policies, where he does not offend the law, or unlawfully infringe upon the rights of others. It is the right of every person or corporation to hire and discharge men at pleasure, subject to liability for damages for breach of contract; and every man has the right to work for another or to quit his service at his pleasure, subject to the same liability. But no person or association of persons has the right to interfere with the

business of another by means of force, menaces, or intimidation, so as to prevent others from entering into or remaining in the employment of his service. In California it was held that a merchant is entitled to an injunction against the maintaining in front of his place of business by a labor union, of pickets bearing placards which tend to intimidate his employees and patrons, with intent to do so, for the purpose of compelling him to pay the prices fixed by the union to his union employees. *Goldberg* v. *Stablemen's Union*, 149 Cal. 429 (8 L.R.A. [N.S.] 460, 117 Am. St. R. 145, 86 Pac. 805). In *American Steel & Wire Co.* v. *Wire Drawers & Die Makers Unions*, 90 Fed. 608, it appeared that the unions massed large bodies around the premises in which a strike was in progress; and the defendants were restrained from collecting in and about the approaches to the complaint's mills for the purpose of picketing, or patroling or guarding the streets, approaches, and gates, for the purpose of intimidating, threatening, or coercing any of the employees, or any persons seeking the employment of complainant. Other cases similar in principle might be added. But these are sufficient to illustrate our point, which is that when strikers patrol the streets and the approaches of the premises where the strike is in progress, and their number is so great, or the conduct is such as to intimidate and coerce the employees into quitting their employment, or others from seeking employment, they are guilty of unlawful acts, and will be enjoined from a continuance of them. Sometimes the number of strikers engaged in the patrol may be so great that those intended to be affected by the demonstration will be intimidated by the number of the strikers or their sympathizers, without special overt acts. The courts have repeatedly held that the assembling of strikers around the establishment of the employer in such numbers as will serve as a menace to those employed, or the keeping of patrols in front of or about the premises of the employer, accompanied by violence or any manner of coercion to prevent others from entering into or remaining in his service, will be enjoined. 24 Cyc. 835, and the numerous cases cited in the note to the text.

While there is some reference in the evidence to the pickets of the strikers having spoken to some employees, the pleadings and evidence do not make a distinct issue of a combination to injure one in his business or trade by inducing by persuasion his employees to violate existing contracts of employment, to the irreparable damage of the employer, so as to require a discussion of such a claim as a basis for injunction, or a decision in regard to it.

As already said, members of a labor union, either individually or as an association, have no right by force, menace, or intimidation, to prevent others from working upon such terms as they are willing to accept, or to hinder by such means any person from employing laborers. In many cases it may be difficult to draw the line of demarcation between intimidation and inoffensive persuasion. In a New York case (*Rogers* v. *Evarts*, 17 N.Y. Supp. 264), it was said:

> It may be impossible to lay down a general rule as to what surrounding circumstances will characterize persuasion and entreaty as intimidation. Each case must probably depend upon its own surroundings. But where evidence presents such a case as to convince the court that the employees are being induced to leave the employer, by operation upon their fears rather than upon their judgments or their sympathy, the court will be quick to lend its strong arm to his protection. Rights guaranteed by law will be enforced by the court, whether invoked by employer or employee.

The very word "picket" is borrowed from the nomenclature of warfare, and is strongly suggestive of a hostile attitude toward the individual or corporation against whom the labor union has a grievance. To quote Mr. Eddy, "It is conceivable, however, that a picket entirely lawful might be established about a factory, but such a picket would go no further than interviews and lawful persuasion and inducement. The slightest evidence of threats, violence, or intimidation of any character ought to be sufficient to convince court and jury of the unlawful character of the picket, since the picket under the most favorable consideration means an interference between employer seeking employees and men seeking employment." 1 Eddy on *Combinations*, section 339. But the law does not forbid employees who have quit their employer from using legitimate argument to induce others to refrain from taking their places. The current of authority is that a court of equity will not enjoin employees who have quit the service of their employer from attempting to persuade, by proper argument, others from taking their places, so long as they do not resort to intimidation or obstruct the public thoroughfares.

There is evidence before the judge that certain machinists in the employment of the E. Van Winkle Gin & Machine Works became dissatisfied and quit their employment. These machinists were members of Atlanta Lodge No. 1 of the International Association of Machinists. The appointed agent of the local lodge, acting for and in behalf of the strikers, demanded of the E. Van Winkle Gin & Machine Works that it adopt certain rules for the conduct of its

business, which demand was refused. For the purpose of enforcing their demand, and to the end that the former employer might not engage men to supply their places, the strikers placed men at every approach to the plant of the plaintiff and the railway stations in the city of Atlanta. There were from four to twelve men doing "picket duty." These pickets accosted every stranger who evinced an intention to enter the manufacturing plant of the plaintiff, for the purpose of inducing him to abandon any intent to seek employment with the Van Winkle Works. One of the pickets suggested to a new man that "while living and doing well they had better stay out." At another time the pickets after endeavoring to induce a man seeking employment to desist, upon his seeming reluctance to yield to their entreaties, said to him: "God damn you, you will have to get out, anyway." On another occasion a man seeking employment approached an employee of the plaintiff and asked to be directed to the plaintiff's shops. This employee volunteered to guide the inquirer, when one of the strikers who was near by came up and asked the person seeking employment if he was a machinist, and upon being informed that he was a machinist looking for a job, the striker began to abuse the shop, saying it was a scab shop and to curse the new men who had gone into the shops to take the places of the strikers, calling them "damned scabs." This man did not apply for a job. These, and similar threats, and the constant surveillance of the plant by the pickets caused other departments of the plaintiff's plant to shut down for lack of machinists. At this juncture of affairs the defendants were restrained by a temporary order from interference with the plaintiff's business; and after the grant of the restraining order, according to the testimony of the superintendent "everything has assumed a different attitude and a feeling of rest and confidence has taken place which did not exist while the premises were picketed." The quoted remarks of the strikers to the men who were seeking work were more than a peaceable and argumentative presentation of their grievance. The language of these pickets was clearly intimidative, and intended to coerce compliance with their request not to work for the plaintiff; and there was no error in enjoining such conduct. The form of the injunction is perhaps too broad, in that the strikers are enjoined from using all form of persuasion. As we have pointed out, it was not unlawful for the strikers to use legitimate argument and moral suasion in presenting their case to those who offered to take their places, so long as it is neither coercive

nor intimidating in character. In affirming the judgment, direction is given to so amend the decree as to make it accord with the opinion of the court in this particular.

Judgment affirmed.

QUESTIONS

1. D *et al.*, some two hundred in number, leave P's employment because of P's refusal to accede to their demands for a shorter working day. Having nothing else to do, they loiter about P's place of business and make slighting remarks to employees and prospective employees. To what relief, if any, is P entitled?
2. D *et al.* congregate about P's premises for the purpose of dissuading prospective employees from accepting employment from P. To what relief, if any, is P entitled?
3. D *et al.* appoint two of their members to picket P's premises for the purpose of inducing P's employees to leave him and to dissuade others from accepting employment from P. To what relief, if any, is P entitled?
4. The two representatives distribute handbills, containing a fair statement of their side of controversy, among P's employees and prospective employees. To what relief, if any, is P entitled?
5. The representatives walk up and down in front of P's place of business wearing this sign: "This place is unfair to organized labor; do not accept employment in it." To what relief, if any, is P entitled?
6. They quietly but firmly warn prospective employees that it will be best for them to seek employment elsewhere. To what relief, if any, is P entitled?
7. Some courts have said that there can be no such thing as peaceful picketing. Is there any justification for such a view?

WILLCUTT & SONS COMPANY *v.* DRISCOLL

200 Massachusetts Reports 110 (1908)

HAMMOND, J. This bill, although originally brought against two unincorporated associations or labor unions by name, has now been amended, so that it runs only against certain individuals as officers and members of these associations and against the other members of those associations as represented by these individuals. No question is made that the defendants do not sufficiently represent all the members of both unions; and the bill is not open to objection upon this ground. *Pickett* v. *Walsh*, 192 Mass. 572, 589, 590, and cases there cited.

The questions before us are raised upon a report of the facts found by the judge of the Superior Court who heard the case. They grew

out of a trade dispute between the plaintiff and the members of the unions who were in its employ. In April, 1906, these unions adopted a code of working rules, in which, beside some minor demands not now material, they demanded that wages be increased five cents an hour, that all foremen should be members of the unions, that the business agent of the unions should be allowed to visit any building under construction to attend to his official duties, and that wages should be paid during working hours. The plaintiff declined to accept these rules, and a strike followed.

By the constitution and rules of the unions it appeared that a code of fines and penalties was established by the International Union, an association composed of these and other similar unions throughout the country, and that this code was being actively enforced by the local unions. One rule provided that any member violating any section of the working code should be fined upon conviction not less than five nor more than twenty-five dollars, one of these sections being that "No member of the union shall work with a non-union man who refuses to join the union." Various other penalties were provided, varying from five to five hundred dollars for each offense, to be imposed upon persons designated as "common scab," "inveterate or notorious scabs," and "union wreckers," these terms being applied to those who in different ways persisted in working after a strike has been called. These fines in their operation are likely to be coercive in their nature.

This code was actively enforced by the unions, and most of the members of the unions who left their work did so through fear of the fines that would be imposed upon them if they continued to work. The defendants, Driscoll and Reagan, on one occasion found two men at work for the plaintiff, one a journeyman who had been, and the other a foreman who then was, a member of the union. Reagan threatened the journeyman with a fine of $100 if he continued to work, and Driscoll notified the foreman that he was called out. Both refused to leave. Driscoll reported the fact at a meeting of the union and a vote was passed that charges be preferred against the men for working contrary to the rules. A preliminary injunction was issued in this case, and no further steps were taken under the vote.

We are of opinion that this strike must be regarded as simply a strike for higher wages and a shorter day. It was not a mere sympathetic strike as in *Pickett* v. *Walsh*, 192 Mass. 572, or one whose immediate object was only remotely connected with the ultimate

object of the strikers, as in *Plant* v. *Woods*, 176 Mass. 492. It was a direct strike by the defendants against the other party to the dispute, instituted for the protection and furtherance of the interests of the defendants in matters in which both parties were directly interested and as to which each party had the right, within all lawful limits, to determine its own course. Such a strike must be treated as a justifiable strike so far as respects its ultimate object.

But however justifiable or even laudable may be the ultimate objects of a strike, unlawful means must not be employed in carrying it on; and it is contended by the plaintiff that the use of fines and threats of fines, under circumstances disclosed in the record, are unlawful. The question is stated by the trial judge in the following language: "In case of a justifiable strike, has the contractor the right to invoke the aid of the court to prevent the labor union from imposing a fine (which the court has found to be coercive in its nature) or taking action to impose one upon one or more of its members under its rules to induce them to leave the contractor's employ to his injury?" Under the findings of the judge it would seem that the question is not intended to be quite so broad as otherwise might be inferred from its language. The language is broad enough to include the case where the employee is under a contract to stay with his employer and where to leave would be a violation of that contract. But no such state of things appears upon the record. The plaintiff "hired its masons by the day and paid them on the basis of the number of hours worked, and it might have discharged them and they might have left at the close of any day." The question must therefore be considered as applying only to cases where the employee by leaving violates no contractual right of the employer.

The question how far the imposition of fines by an organization upon its members where the effect is to injure a third party is justifiable, was considered by this court in *Martell* v. *White*, 185 Mass. 285; and it was there adjudged that the imposition of such a fine by which members of the organization were coerced into refusing to trade with the plaintiff, not a member, to his great damage, was inconsistent with the ground upon which the right to competition in trade is based, and as against him was not justifiable. In the course of the opinion the case of *Boutwell* v. *Marr*, 71 Vt. 1, was cited in which the same conclusion was reached. In *Martell* v. *White* five justices sat, and four of them, being a majority of the whole court, concurred in the ground upon which it was decided. The case was

carefully prepared by counsel, the questions involved were apparently so important, and there was a difference of opinion among the judges who sat in it. It was therefore considered at great length, and the conclusion was reached after a most exhaustive discussion and the most careful deliberation. It stands as a solemn adjudication by the court after such discussion and deliberation. So far as respects the court of judicial opinion and authority there has been no change since the decision was announced unfavorable to it or to the ground upon which it was reached. On the contrary, so far as we are aware, whenever the case has been mentioned by members of the profession, whether they be judges engaged in the practical administration of the law, or professors teaching the students of our courts the true theory of legal principles, it has been received with favorable comment. See Bossert v. Dhuy, 221 New York, 342, 117 N. E. 565, L. R. A. 1918C, 497, Ann. Cas. 1918B, 1164; Frankfurter & Greene, The Labor Injunction, 42 Harvard Law Review, 345, 356; 37 Yale Law Journal, 1, 11; 27 Yale Law Journal, 914, 926; 27 Harvard Law Review, 561, 563; 27 Yale Law Journal, 1, 11. There is every reason why the decision of this court should apply, and, so far at least as respects the Commonwealth, the case must be held as settling the correctness of the principle upon which the decision was based.

What of the complaint of the plaintiff? It is a corporation engaged in the construction of buildings and employing a number of men. Its men left its employ on a strike. To keep them away the defendants concerned with them had at most exercised the right, and by that means kept them away from the plaintiff when otherwise they would have stayed—all to the great damage of the plaintiff. Every aspect the case is now. The plaintiff's men are being coerced by threats of a ban to leave its employ; greatly to its injury, the hand to be levied in accordance with the by-laws of a voluntary association of which the proposed victims are members. The injury to the plaintiff is intended by the defendants. Has the plaintiff any standing in equity to an injunction against the infliction of such injury?

It is to be premised that the right which the plaintiff seeks to have protected against the acts of the defendants arises from no contract or statute, but out of the nature of things. It is one of the large body rights which have the foundation in the living necessities of civilized society. It is the common law right to a reasonably free labor market. Wage-earning business, in speaking of it, says it has been called a "probable expectancy," and describes it

as "the right which every man has to earn his living or pursue his trade without undue interference." *Jersey City Printing Co.* v. *Cassidy*, 18 Dick. 759. He further remarks (pp. 765, 766): "It will probably be found that the natural expectancy of employers in relation to the labor market and the natural expectancy of merchants in respect to the merchandise market must be recognized to the same extent by courts of law and courts of equity and protected by substantially the same rules. It is freedom in the market, freedom in the purchase and sale of all things, including both goods and labor, that our modern law is endeavoring to insure to every dealer on either side of the market." And in *Atkins* v. *Fletcher Co.*, 20 Dick. 658, 664, the same judge says: "The elemental right of the employer of labor which the courts recognize today no doubt is the right to employ, while the corresponding right of the workman is the right to be employed. In other words, the right to buy labor and the right to sell labor are recognized by the law, and their enjoyment is greatly impaired or destroyed unless freedom in the labor market—freedom on both sides of the labor market—is maintained. Each party to a contract for the sale of labor is interested in the freedom of the other party with respect to making the contract." In the words of Lord Lindley in *Quinn* v. *Leathem* (1901) A.C. 495, 534: "A person's liberty or right to deal with others is nugatory unless they are at liberty to deal with him if they choose to do so." This right of the employer is conclusively established by the numerous cases which hold that he may maintain an action against those who by intimidation prevent persons from entering into its employ. See remarks of Lord Halsbury in *Allen* v. *Flood* (1898), A.C. 1, 71, 72. In our own reports such a case may be found in *Vegelahn* v. *Guntner*, 167 Mass. 92. This is the right—the right to a free labor market—which the plaintiff asserts has been invaded by the defendants, and for which he seeks protection.

The defendants also have rights. They have the right to work or not to work, to sell their labor upon such terms as they see fit and to combine for the purpose of getting more pay or a shorter day. And for the purpose of strengthening their organization and making it more effective they have the right to make appropriate by-laws for its internal management, and for the regulation of the conduct of its members toward each other in matters affecting the general interests of the body; and they may enforce obedience to such by-laws and regulations by fines and other suitable penalties.

But not much progress is made by this general statement of the rights of the respective parties. We are still only on the skirmish line. In the jurisprudence of any civilized country there are but few, if any, absolute rights—rights which bend to nothing and to which everything else must bend. The rights of one's life would seem to be quite absolute, but it must yield to the private right of self-defense and to the public right to punish for crime. And so in the case before us, neither the right of the plaintiff to a free labor market nor the right of the union to impose a fine upon its members is absolute. Neither is to be considered apart from the other, or without reference to any other conflicting right, whether public or private; but each must be regarded as having in the rules of human conduct its own place beyond the limits of which it must not go.

Moreover it must be borne in mind (what sometimes seems to be forgotten by the actors upon each side of such controversies) that the controversy is not a warfare in the sense that for the time being the usual rules of conduct are changed, as in the case of an actual war between two countries There is no martial law in these cases, no change in the ordinary rules of society, but these rules remain the same as before, commanding what was theretofore right and prohibiting what was theretofore wrong.

The right of an employer to free labor is subject to the right of the laborer to hamper him by many expedients short of fraud or intimidation amounting to injury to the person or property of those who desire to enter his employ, or threats of such injury. For instance, persuasion not amounting to such intimidation is lawful, and perhaps the same may be said of social pressure even when carried to the extent of social ostracism, not including, however, any threat in a business point of view. See *Vegelahn* v. *Guntner*, 167 Mass. 92; *Jersey City Printing Co.* v. *Cassidy*, 18 Dick. 759, 769; 20 Harvard Law Review, 267. Social rights and privileges must take care of themselves. The law cannot prescribe with whom one shall shake hands or associate as a friend.

So long also as the by-laws of a union relate to matters in which no one is interested except the association and its members, and violate no right of a third party or no rule of public policy, they are valid. Fines may be imposed, for instance for tardiness, absence, failure to pay dues, or for misconduct, affecting the organization or any of its members, and for numerous other acts. It cannot be successfully contended, however, that as against the right of some party other

than the association and its members an act, otherwise a violation of the third party's rights, is any less a violation because done by some member in obedience to a by-law. If a member commits an assault upon a person, and is called into court by the Commonwealth upon a criminal complaint, or in a civil action by the victim, he can find no valid ground of defense in the fact that he committed the assault in compliance with the requirements of a contract with some other person, or in obedience to a by-law of an association of which he was a member. So a by-law providing that, upon an order to strike, every employee shall quit work even although such an act should be in violation of a contract then existing between him and this employer for continuous service, and that for failure thus to break his contract the member should be fined, doubtless would be declared invalid. And the principle at the bottom of such a decision is this, namely: An interference with the right of a third party cannot be justified upon the ground that the intruder is acting in accordance with an agreement between him and some other person. In a word, so long as a fine is imposed for the guidance of members in matters in which outside parties have no interest, or in which there is no violation of a right of an outside party, then no such party can complain. But when the right of such a party is invaded, it is no defense, either to the person fined or to those who have imposed the fine, that the invasive act was done in accordance with the by-laws of an association.

In the case before us, standing opposed to each other, are these two rights: the right of the employer to a free labor market, and the right of the striking employees in their strife with him to impair that freedom; and the crucial question is, how far can the latter go? On which side of the line shall stand the matter of coercion by fines imposed by a union upon its members to impair that freedom? Is the employer's right to a free market subject to this system of mutual intimidation and coercion by fines, or is the right to establish such a system subject to the right of the employer to a free market? If the employer's right is not subject to this method of intimidation, then of course as against him it is unlawful. If it is subject to it, then he cannot complain, no matter how severe the blow.

So far as concerns the law in this Commonwealth at least, some things seem to be settled. It is settled that the flow of labor to the employer cannot be obstructed by intimidation or coercion produced by means of injury to person or property or by threats of such injury.

Vegelahn v. *Guntner*, 167 Mass. 92. In that case ALLEN, J., said: "Such an act [picketing as a means of intimidation] is an unlawful interference with the rights both of employer and of employee."

An employer has a right to engage all persons who are willing to work for him at such prices as may be mutually agreed upon; and persons employed or seeking employment have a corresponding right to enter into or remain in the employment of any person or corporation willing to employ them. These rights are secured by the Constitution itself. *Commonwealth* v. *Perry*, 155 Mass. 117; *People* v. *Gillson*, 109 N.Y. 389; *Braceville Coal Co.* v. *People*, 147 Ill. 66, 71; *Ritchie* v. *People*, 155 Ill. 98; *Low* v. *Rees Printing Co.*, 41 Neb. 127. See also *Sherry* v. *Perkins*, 147 Mass. 212. And it is unnecessary to cite cases in support of the proposition that such is the great weight of authority elsewhere, even though the ultimate object of the strike be legal.

There can be no doubt that fining is one method of injuring a man in his estate, and that a threat to fine is a threat of such an injury. Indeed this is recognized by the decree made by the trial court in this very case, so far as it affects Reagan, one of the defendants, who, it was found, had threatened with a fine a man once but not then a member of a union.

It is urged, however, that although this method of intimidation is generally an invasion of the employer's right to a free market and therefore illegal, yet when the intimidation is exerted by a union upon its members in accordance with its by-laws in a strike whose object is legal, it is justifiable and legal. To this the obvious reply is that the rule of freedom to contract is founded upon principles of public policy, that each party to a contract is interested in the freedom of the other party, that it can make no difference to the public or to the employer (who in the present case is the other party), that the person intimidated is or is not a member of the society intimidating. In either case the injury is the same and is from the same cause, namely, intimidation. The workman is no longer free. In *Longshore Printing Co.* v. *Howell*, 26 Ore. 527, the court, after speaking of the general right of labor unions to make rules, proceeds thus: "It must be understood, however, that these associations, like other voluntary societies, must depend for their membership upon the free and untrammeled choice of each individual member. No resort can be had to compulsory methods of any kind to increase or keep up or maintain such membership. Nor is it permissible for associations of this kind

to enforce the observance of their laws, rules, and regulations through violence, threats, or intimidation, or to employ any methods that would induce intimidation or deprive persons of perfect freedom of action."

If it be said that fines are not in themselves illegal, and that consequently their use cannot be illegal, the answer is that when they are used as a method of coercion and create a kind of coercion inconsistent with the right of a person they are, as against that person's right, illegal. If it be said, as we have heard it said, that fines are innocent and cannot be illegal because they are used by all governments as a method of punishing criminals, the answer is that if the principle is true that, what a government may do to punish for crime, individuals or societies may do to enforce private rights, then it follows that a by-law providing for imprisonment or even death may be legal.

If it be said that the member fined may take his choice either to leave the organization or abide by its rules to which he has before assented, and that where there is a choice there can be no coercion, the answer is that in almost every conceivable case of coercion short of an actual overpowering of the physical forces of the victim there is a choice. The highwayman, who presents his cocked pistol to the traveler and demands his purse under pain of instant death in case of refusal, offers his victim a choice. He may either give up his purse and live, or refuse and die. In *Carew* v. *Rutherford*, 106 Mass. 1, the victim had a choice either to pay a fine or take the consequences of a refusal. And so the member of a labor union has the choice either to pay the fine or leave the union. Is it difficult to realize what that choice is in these days of organized labor? Is it too much to say that many times it is very difficult, indeed practically impossible, for a workman to get bread for himself and his family by working at his trade unless he is a member of a union? It is true he has a choice between paying his fine and not paying it, but is it not frequently a hard one? May not the coercion upon him sometimes be most severe and effective? Such is not a free choice. And a market filled with such men is not a reasonably free market. In this connection the language of *Boutwell* v. *Marr*, 71 Vt. 1, seems significant and appropriate: "The law cannot be compelled by any initial agreement of an associate member to treat him as one having no choice but that of the majority, nor as a willing participant in whatever action may be taken. The voluntary acceptance of by-laws providing for the imposition of coercive fines does not make them legal and collectible.

The fact that the relations and processes deemed essential to a recovery are brought within the membership and proceedings of an organized body cannot change the result. The law sees in the member of an association of this character both the authors of its coercive system and the victims of its unlawful pressure. If this were not so, men could deprive their fellows of established rights, and evade the duty of compensation simply by working through an association."

If it be said that without fines the same result may be indirectly reached by the organization by exercising two rights, namely, the right to expel a member and the right to charge an initiation fee upon his return, and since the same result may thus be legitimately reached, nobody is harmed if it be reached by fine, the reply is that if the purpose of expulsion and the subsequent initiation fee be each a part of one and the same transaction, namely, the imposition of a fine, and the two acts are in substance the procedure by which the intimidation by fine is exercised, and such is the intention, then there may be a strong reason for holding that such a procedure is one imposing a fine and should be treated as such. Ordinarily, however, each separate act should be treated by itself and its validity judged by itself. The fact that separately and independently executed they incidentally may have the effect of a fine is immaterial on the question of the right to fine. The fact that a result may be incidentally reached in one way does not show that the same result may be lawfully reached in another way.

In considering this question we cannot lose sight of the great power of organization. It should be taken into account when one is considering where the line should be drawn between the right of the employer to a free market and the right of workmen to interfere with that market by coercion through the rules of a labor union. It is not universally true that what one man may do any number of men by concerted action may do. In *Pickett* v. *Walsh*, 192 Mass. 572, LORING, J., after alluding to the great increase of power by combination, says: "The result of this greater power of coercion on the part of a combination of individuals is that what is lawful for an individual is not the test of what is lawful for a combination of individuals; or to state it in another way, there are things which it is lawful for an individual to do which it is not lawful for a combination of individuals to do."

In view of these considerations and of others more fully set forth in *Martell* v. *White*, which are not here repeated, and in *Boutwell* v.

Marr, ubi supra, a majority of the court are of opinion that the overwhelming sense of the thing is that the principle that the right of the employer is not subject to coercion or intimidation by injury or threats of injury to the persons or property of laborers standing in the market to meet him, should apply to the coercion and intimidation exerted by labor unions upon their members by fines or threats of fines. Any other conclusion is inconsistent with the existence of a reasonably free labor market to which both the employer and the employee are entitled.

The result is that in the opinion of a majority of the court there should be a decree restraining and enjoining the defendants, their agents, and servants from intimidating by the imposition of a fine, or by a threat of such fine, any person or persons from entering into the employ of the plaintiff or remaining therein; or from in any way being a party or privy to the imposition of any fine or threat of such imposition upon any person desiring to enter into or remain in the employ of the plaintiff.

QUESTIONS

1. Why was the conduct of the defendants held illegal in the principal case?
2. P, normally employing union labor, employed X, a non-union man. D and other employees of P, members of a union, voted to fine P $500 and to enforce the fine by a strike unless P discharged X. P discharged X. What are the rights of P, if any, under the circumstances?
3. In the foregoing case, P paid the fine under protest. Later P brought an action to recover the amount so paid. What decision?
4. The D Union informs X that he will be expelled from the union unless he joins in a strike which is to be called in P's plant. X joins in the strike. (*a*) What are the rights of P? (*b*) What are the rights of X?
5. In the foregoing case, the union informs X that if expelled he will not be readmitted to the union except upon the payment of a fee of $100. X joins the strike. (*a*) What are the rights of X? (*b*) What are the rights of P?
6. The striking employees cut off all social communications with the non-striking employees and thereby force the latter to join the strike. What are the rights, if any, of P under the curcumstances?

GLAMORGAN COAL COMPANY *v.* SOUTH WALES MINERS' FEDERATION

Law Reports 2 King's Bench Division 545 (1903)

The Glamorgan Coal Co. and seventy-three other plaintiffs, owners of collieries in South Wales, brought this action against the

South Wales Miners' Federation, its trustees and officers, and a number of the members of its executive council, claiming damages for wrongfully and maliciously procuring and inducing workmen employed in the plaintiffs' collieries to break their contracts of employment with the plaintiffs. In the alternative the plaintiffs sued the defendants for wrongfully and maliciously conspiring together to do the acts complained of. In this action the plaintiffs asked for damages and an injunction.

In November of 1900, the council of the Miners' Federation, fearing that the price of coal would fall with the consequent reduction in wages, forbade all employees of the plaintiffs to work on November 9. In pursuance of this vote, over one hundred thousand men took a holiday and, as alleged by the plaintiffs, broke their contracts of service. Later on, at a conference of the miners the council was authorized to declare a general holiday at any time that it should see fit for the purpose of keeping the price of coal up. In pursuance of this authorization, on four different occasions during October and November of 1901, general holidays were decreed by the council which were obeyed by the men in breach of their contracts of employment.

BIGHAM, J., found that the federation and all of the other defendants had acted honestly and without malice in ordering these "stop-days" and had done no more than what they conceived to be in the best interests of the men whom they represented. He found, moreover, that they had lawful justification or excuse for what they did in this—that having been solicited by the men to advise and guide them on the questions of "stop-days," it was their duty and their right to give the advice and do what might be necessary to see that the advice should be followed.

The court gave judgment for the defendants and from this judgment the plaintiffs prosecuted the present appeal.

ROMER, L. J. The law applicable to this case is, I think, well settled. I need only refer to two passages in which that law is shortly and comprehensively stated. In *Quinn* v. *Leathen* (1901), A.C. 495, at page 510, LORD MACNAGHTEN said: "A violation of a legal right committed knowingly, is a cause of action, and it is a violation of legal right to interfere with contractual relations recognized by law if there be no sufficient justification for the interference." And in the *Mogul Steamship Co.* v. *McGregor*, 23 Q.B.D. 598, at page 614, BOWEN, L. J., included in what is forbidden "the intentional

procurement of a violation of individual rights, contractual or otherwise, assuming always that there is not just cause for it." But although, in my judgment, there is no doubt as to the law, yet I fully recognize that considerable difficulties may arise in applying it to the circumstances of any particular case. When a person has knowingly procured another to break his contract, it may be difficult under the circumstances to say whether or not "there was sufficient justification or just cause" for his act. I think it would be extremely difficult, even if it were possible, to give a complete and satisfactory definition of what is "sufficient justification," and most attempts to do so would probably be mischievous. I certainly shall not make the attempt. In particular I do not think it necessary or useful to discuss the point as to how far the question of justification can be assimilated to the question of malice in cases of libel and slander. As COLLINS, M. R., said in *Read* v. *Friendly Society of Operative Stonemasons:* (1902) 2 K.B. 732, "It is not at all necessary in this case to embark upon the question whether 'without just cause' is a complete equivalent for what was meant in the common law by 'malice.' I am inclined to think that, though in many cases adequate as a description, it is not co-extensive with it, nor do I think that in civil action any more than in criminal it will be possible to eliminate motives from the discussion." I respectfully agree with what BOWEN, J. L., said in the Mogul Case when considering the difficulty that might arise whether there was sufficient justification or not: "The good sense of the tribunal which had to decide would have to analyze the circumstances and to discover on which side of the line each case fell." I will only add that, in analyzing or considering the circumstances, I think that regard might be had to the nature of the contract broken; the position of the parties to the contract; the grounds for the breach; the means employed to procure the breach; the relation of the person procuring the breach to the person who breaks the contract; and I think also to the object of the person in procuring the breach. But, though I deprecate the attempt to define justification, I think it right to express my opinion on certain points in connection with breaches of contract procured where the contract is one of master and servant. In my opinion, defendant sued for knowingly procuring such a breach is not justified of necessity merely by his showing that he had no personal animus against the employer, or that it was to the advantage or interest of both the defendant and the workman that the contract should be broken. I take the following simple case to illustrate my view. If A wants to

get a specially good workman, who is under contract with B, as A knows, and A gets the workman to break his contract to B's injury by giving him higher wages, it would not, in my opinion, afford A a defense to an action against him by B, that he could establish he had no personal animus against B, and that it was both to the interest of himself and of the workman that the contract with B should be broken. I think that the principle involved in this simple case, taken by me by way of illustration, really governs the present case. For it is to be remembered that what A has to justify is his action, not as between him and the workman, but as regards the employer B. And, if I proceed to apply the law I have stated to the circumstances of the present case, what do I find? On the findings of the fact it is to my mind clear that the defendants, the federation, procured the men to break their contracts with the plaintiffs, so that I need not consider how the question would have stood if what the federation had done had been merely to advise the men, or if the men, after taking advice, had arranged between themselves to break their contracts, and the federation had merely notified the men's intentions to the plaintiffs. The federation did more than advise. They acted and by their agents actually procured the men to leave their work and break their contracts. In short, it was the federation who caused the injury to the plaintiffs. This was practically admitted before us by the counsel for the federation, and, indeed, such an admission could not, in my opinion, be avoided, having regard to the facts stated by the learned judge in his judgment. And it is not disputed that the federation acted as they did knowingly. So that the only question which remains is one of justification. Now the justification urged is that it was thought and I will assume for this purpose rightly thought, to be in the interest of the men that they should leave their work in order to keep up the price of coal on which the amount of wages of the men depended. As to this, I can only say that to my mind the ground alleged affords no justification for the conduct of the federation toward the employers; for, as I have already pointed out, the absence on the part of the federation of any malicious intention to injure the employers in itself affords no sufficient justification. But it was said that the federation had a duty toward the men which justified them in doing what they did. For myself I cannot see that they had any duty which in any way compelled them to act, or justified them in acting, as they did toward the plaintiffs. And the fact that the men and the federation, as being interested in

or acting for the benefit of the men, were both interested in keeping up prices, and so in breaking the contracts affords in itself no sufficient justification for the action of the federation as against the plaintiffs as I have already pointed out. I think, therefore, that the appeal must succeed.

QUESTIONS

1. Would the same decision have been reached in this case had the workers not been under contracts of service with their employers?
2. Would the same decision have been reached if the defendants had been ignorant of the contracts of service between the workers and their employers?
3. The court said in this case that the procurement of a breach of contract is actionable unless the person inducing the breach can show a justification. What will constitute a justification for knowingly inducing a breach of contract?
4. X is under a contract of employment with P for a period of one year. D, honestly believing that P is paying X insufficient wages, persuades X to break his contract of employment with P. P sues D for damages. What decision?
5. P, a non-union carpenter, is under a contract of employment with X. D, a union man in X's employ, persuades X to discharge P so that Y, a union man, can get employment. P sues D for damages. What decision?
6. D *et al.*, under contracts of employment with P, strike for higher wages. D *et al.* then attempt to persuade M *et al.*, also under contracts of employment with P, to join with them in the strike. What are the rights of P against D *et al.*?

PARKINSON COMPANY *v.* BUILDING TRADES COUNCIL

154 California Reports 581 (1908)

Sloss, J. What is particularly to be borne in mind is that we are not here concerned with a strike or boycott presenting any of the features of violence, either expressly or impliedly threatened, to be found in so many of the decided cases. There was here no effort or threat to interfere by physical force with the plaintiff or its employees, nor any intimidation of employees or customers, using the term "intimidation" as meaning an act tending to inspire fear of violence to person or property. One may, to be sure, be put in fear of violence without the use of any word indicating an intent to resort to force. "Picketing," as practiced in labor disputes, may, and perhaps usually does, constitute an intimidation of the employees and patrons of

the person whose establishment is picketed (*Goldberg* v. *Stablemen's Union*, 149 Cal. 429; 117 Am. St. Rep. 145; 86 Pac. 806). The carrying, near a place of business, of banners calling upon laborers to remain away from such place, has been treated as a form of menace directed against those who might seek employment (*Sherry* v. *Perkins*, 147 Mass. 212; 9 Am. St. Rep. 689; 17 N.E. 307). So, too, words, which of themselves, purport to express merely a request, may be uttered in such manner and under such circumstances as to convey to the hearer a plain threat that refusal to comply with the request (or demand) will result in physical harm to him. None of these considerations are, however, presented in this case.

Nor need we here consider how far it is unlawful, whether by persuasion or other means, to induce one of the parties to a contract to break it to the damage of the other. As is pointed out in the opinion of the chief justice, any acts of this character that may have been committed by the defendants had occurred prior to the commencement of the action, and there was no evidence that any further interference in this direction was to be anticipated. There was, therefore, no basis for enjoining such acts.

The real question in the case turns upon the activities of the defendants exerted in two ways: (1) in ceasing to work for the plaintiff (striking); and (2) in notifying (or threatening, if that term be preferred) the customers of plaintiff that workmen affiliated with the Building Trades Council would not work for contractors using materials purchased of plaintiff.

That workmen employed by the Parkinson Company had a right to leave its employ whenever they desired, and for any reason that might seem to them sufficient, is universally conceded. Was it unlawful to notify contractors dealing with the Parkinson Company that union men would not continue to work for them if they purchased material of said Parkinson Company? In this inquiry, I think it is important that the defendants were merely acting in accordance with a rule adopted before any difference with the plaintiff had arisen. The opinion of the chief justice appears to proceed upon the theory that, since the defendants had bound themselves to act in a certain way in the event of a controversy of this kind, was not only proper, but laudable, for them to notify contractors of their intended action and of the consequences which would follow to contractors who should continue to deal with the plaintiff. More than this, that it was in some way incumbent upon plaintiff to notify contractors dealing with

him that a continuance of their patronage would be likely to result in loss to them. I cannot agree to the proposition that the rights of the parties are in any way affected by such considerations. If the defendants' course of conduct amounted to an unlawful interference with plaintiff's rights, it was not made lawful by the fact that the defendants had decided, in advance, to act in this way whenever an occasion should present itself.

But was their action unlawful? They had a right, as has been said, to cease working for Parkinson. They had an equal right to cease working for any other employer. Upon what ground, then, is it claimed that while their refusal to work for plaintiff gave plaintiff no cause of complaint, the refusal to work for others did give plaintiff a ground of action? Because, it is said, they are bringing to bear upon the Parkinson Company, with which they have a controversy, the pressure of loss inflicted by third persons, not connected with the main dispute, and are, by holding over these third persons the risk of financial loss, compelling them, against their will, to inflict upon Parkinson the damage resulting from a cessation of their patronage. This is the argument commonly advanced to establish the illegality of what has been called, in much of the recent discussion of the subject, a "secondary" rather than a "primary" boycott. I do not see that we are helped to a solution of the question of the illegality of the defendants' acts by looking into the "motive" or "intent" with which they acted. Even if we assume, contrary to the decisions of this court, that an improper motive may, as a general proposition, render actionable an act otherwise lawful or to use another form of statement, that damage intentionally inflicted will be actionable unless its infliction can be justified by showing that it was inspired by a proper motive, the motive with which these defendants acted was not, in my opinion, one which the law regards as improper. The defendants were seeking, in all they are shown to have done, to secure employment by the plaintiff for themselves, to the exclusion of those not associated with them, and to secure the employment upon terms deemed satisfactory or advantageous to them. That is the effort of every dealer in goods, it is the struggle of competition, and is no more to be frowned upon where the subject of trade is labor than where it is a specific commodity. The uniting or combining of a number of persons to accomplish a lawful object by lawful means will not, *per se*, render the conduct of the many any more unlawful than would be the same conduct on the part of any one of them. As is

said by Mr. JUSTICE HOLMES in his dissenting opinion in *Vegelahn* v. *Guntner*, 167 Mass. 92, 108:

> It is plain from the slightest consideration of practical affairs, or the most superficial reading of industrial history, that free competition means combination, and that the organization of the world, now going on so fast, means an ever increasing might and scope of combination. One of the eternal conflicts out of which life is made up is that between the effort of every man to get the most he can for his services, and that of society, disguised under the name of capital, to get his services for the least possible return. Combination on the one side is patent and powerful. Combination on the other is the necessary and desirable counterpart, if the battle is to be carried on in a fair and equal way.

The injunction, then, must rest upon the principle that it is unlawful, in an effort to compel A to yield a legitimate benefit to B, for B to demand that C withdraw his patronage from A, under the penalty of losing B's services or patronage, to which he has no contract right. That there are many cases sustaining the affirmative of this proposition is true. *Thomas* v. *Cincinnati, etc., Railway Co.*, 62 Fed. 803; *Hopkins* v. *Oxley Stove Co.*, 83 Fed. 912; *Vegelahn* v. *Guntner*, 167 Mass. 92; *Beck* v. *Railway Teamsters' Protective Union*, 118 Mich. 497; *Gray* v. *Building Trades Council*, 91 Minn. 171; *Barr* v. *Essex Trades Council*, 53 N.J. Eq. 101; *Lucke* v. *Clothing C. & T.A.*, 79 Md. 396; *Jackson* v. *Stanfield*, 137 Ind. 592; *Crump* v. *Commonwealth*, 84 Va. 927.

So are there many to the contrary. *Mogul Steamship Co.* v. *McGregor*, L.R. (1892) App. Cas. 25; *National Protective Association* v. *Cumming*, 170 N.Y. 315; *Clemmitt* v. *Watson*, 14 Ind. App. 38; *Cote* v. *Murphy*, 159 Pa. St. 420; *Macauley Bros.* v. *Tierney*, 19 R.I. 255; *Bohn Manufacturing Co.* v. *Hollis*, 54 Minn. 223; *Payne* v. *Western, etc., Railroad Co.*, 13 Lea 507; *Heywood* v. *Tillson*, 75 Me. 225; *Raycroft* v. *Tayntor*, 68 Vt. 219; *State* v. *Van Pelt*, 136 N.C. 633; *Lindsay & Co.* v. *Montana Federation of Labor*, 37 Mont. 264.

Upon a consideration of the authorities I think the sounder rule is that one who is under no contract relation to another may freely and without question withdraw from business relations with that other. This includes the right to cease to deal, not only with one person but with others; not only with the individual who may be pursuing a course deemed detrimental to another who opposes it, but with all who by their patronage aid in the maintenance of the objectionable policies. In other words, if the defendants violated no right of

the Parkinson Company by refusing to work for it, they violated none by refusing to work for contractors who used materials bought of Parkinson. Such refusal, as is shown in the opinion of the chief justice, and as is stated in the testimony of plaintiff's manager and principal witness, was the "sum total of the interference" which was practiced or threatened. An agreement by shipowners, in order to secure a carrying trade exclusively for themselves, that agents of members should be prohibited upon pain of dismissal from acting in the interest of competing shipowners (*Mogul Steamship Co.* v. *McGregor*, L.R. [1892] App. Cas. 25); a combination of retailers binding the members to refuse to purchase of wholesalers who should sell to non-members of the combination (*Bohn Manufacturing Co.* v. *Hollis*, 54 Minn. 223; *Macauley Bros.* v. *Tierney*, 19 R.I. 255); an agreement of contractors to withdraw their patronage from wholesalers selling to a contractor who had conceded the demands of his employees for an eight-hour day (*Cote* v. *Murphy*, 159 Pa. 420); a threat by a railroad company to discharge any employee who should deal with the plaintiff (*Payne* v. *Western, etc., Railroad Co.*, 13 Lea, 507); a threat by an employer that he would discharge any laborer who rented plaintiff's house (*Heywood* v. *Tillson*, 75 Me. 225), have been held to give no right of action to the individuals affected. The defendants in each case were held to be acting within their absolute legal right in entering or refusing to enter into business relations with persons to whom they were not bound by contract. I see no reason why workmen have not the same absolute right to dispose of their labor as they see fit. So long as they abstain from breach of contract, violence, duress, menace, fraud, misrepresentation, or other unlawful means, they may lawfully inflict such damage as results from the withholding of their labor or patronage. To quote again from JUDGE HOLMES'S opinion in *Vegelahn* v. *Guntner*, 167 Mass. 92:

> If it be true that workingmen may combine with a view among other things, to getting as much as they can for their labor, just as capital may combine with a view to getting the greatest possible return, it must be true that when combined they have the same liberty that combined capital has to support their interests by argument, persuasion, and the bestowal or refusal of those advantages which they otherwise lawfully control.

The terms "intimidation" and "coercion" so frequently used in the discussion of this question, seem to me to have no application to such acts as were here committed. One cannot be said to be "intimidated" or "coerced" in the sense of unlawful compulsion, by being induced to forego business relations with A, rather than lose the benefit of more profitable relations with B. It is equally beside the question

to speak of "threats," where that which is threatened is only what the party has a legal right to do.

It may be that the combination of great numbers of men, as of great amounts of capital, has placed in the hands of a few persons an immense power and one which, in the interest of the general welfare, ought to be limited and controlled. But if there be, in such combinations, evils which should be redressed, the remedy is to be sought, as to some extent it has been sought, by legislation. If the conditions require new laws, those laws should be made by the law-making power, not by the courts.

QUESTIONS

1. P's employees are on a strike for higher wages. The striking employees thereafter refuse to deal with P or to use the commodity which he sells. To what relief, if any, is P entitled?
2. (*a*) The employees appeal to all organized labor to refuse to deal with P. (*b*) They publish in newspapers a fair account of the controversy and ask all "who believe in fair play to keep away from P's place of business." (*c*) They publish in newspapers the statement that P is "unfair to organized labor." (*d*) They appoint two men to picket P's place of business and these two men in an orderly manner dissuade prospective customers from dealing with P. (*e*) By fraud, defamation, force, and threats of violence, they keep many prospective customers away from P's place of business. To what relief, if any, is P entitled in the foregoing cases?
3. P was engaged in buying and selling building materials to contractors. His employees went out on a strike for higher wages. The national council of workers, of which P's employees were members (*a*) asked all contractors to refuse to buy building materials from P, (*b*) notified contractors that in case they purchased materials from P their employees would be called out on a strike, (*c*) called a strike of employees of several contractors who persisted in buying materials from P after the warning. To what relief, if any, is P entitled in the foregoing cases?
4. P was engaged in the manufacture of brewing machinery and equipment. P's employees were called out on a strike for higher wages. The national trade council notified all union members not to drink beer brewed by brewers who bought machinery and equipment from P. To what relief, if any, is P entitled?
5. P's employees were on a strike for higher wages. P secured a number of strike-breakers to take the places of the striking employees. The union notified all shops and restaurants in the vicinity of P's place of business that the patronage of all members would be withdrawn from those who in any way served the strike-breakers. To what relief, if any, is P entitled?

BOYER *v.* WESTERN UNION TELEGRAPH COMPANY
124 Federal Reporter 246 (1903)

ROGERS, DISTRICT JUDGE. The plaintiffs named in the bill, for themselves and for others whom they describe as the "remaining members of Local Lodge No. 3, of St. Louis, of the Commercial Telegraphers' Union of America," filed this bill in equity and ask for an injunction. A careful examination of the bill shows that the gist of it is this:

That the defendant, having become aware that plaintiffs had become members of an organization known as the Commercial Telegraphers' Union of America, immediately discharged them without notice or other cause; that the defendant, its officers, and agents have unlawfully combined and confederated together to destroy the said union, and intend discharging all the members of said union from the service of the defendant, and by threats, intimidation, and coercion, and otherwise, are interfering with your orators and with others of their employees for uniting with the Commercial Telegraphers' Union of America, and are seeking to prevent those discharged from obtaining employment as telegraph operators; that defendant has established and maintained what is commonly known as a "blacklist." It is a list of persons who have been in their employ and who have been discharged by the defendant, on which are placed from time to time the names of persons incurring the displeasure of the defendant company, and its officers and chief operators; and the defendant, by methods which are not fully known to your orators, and which cannot be fully set forth herein, prevents persons whose names are on said blacklist from again obtaining employment as telegraph operators; that your orators' names have been placed on said blacklist solely because they have become members of the Commercial Telegraphers' Union of America, and it is the intention of the defendant for the same reason to discharge from their employ and place upon said blacklist the names of several hundred other persons who are members of the Local Lodge No. 3 of the Commercial Telegraphers' Union of America, and thereby debar these your orators and said other persons from obtaining employment at their respective locations as telegraph operators, etc.

The first cause of complaint is that plaintiffs have been discharged without notice from the service of the defendant for no other cause than that they joined that union. But the answer to that complaint is that in a free country like ours every employee, in the absence of contractual relations binding him to work for his employer a given length of time, has the legal right to quit the service of his employer without notice, and either with or without cause, at any time; and

in the absence of such contractual relations any employer may legally discharge his employee, with or without notice, at any time.

The second ground for complaint is that defendant, its officers, and agents, have unlawfully combined and confederated together to destroy the said union, and intend discharging all the members of said union from the service of the defendant, and by threats, intimidation, and coercion, and otherwise, are interfering with the plaintiffs and with others of their employees for uniting with the union, and are seeking to prevent those discharged from obtaining employment. I need not take time to multiply authorities to show that there is no such thing in law as a conspiracy to do a lawful thing. If the last allegation means anything, it is that the defendant, its officers, and agents have conspired to destroy the union by discharging all its members in its employ, and refusing to employ others, solely for the reason that they were members of the union. But it is not unlawful, in the absence of contractual relations to the contrary, to discharge them for that or other reason, or for no reason at all. Hence there is no such thing in law as a conspiracy to do that, and it matters not whether you call such an agreement a conspiracy, a combination, or a confederation.

But it is said that the defendants "by threats of intimidation and coercion, and otherwise, so interfered with plaintiffs and others of its employees" because they united with said union. But it does not appear what the threats were, what the intimidation was, or what the coercion was, of which they complain. Such an allegation is not one of fact; it is one of conclusion. What did the defendant threaten to do? Perhaps it was to discharge them, or perhaps, if not employed by it already, not to employ them. But such a threat is not illegal. It is not illegal to threaten to do a lawful thing. It may be defendant threatened to employ non-union men, instead of members of the union; but that, if true, is not illegal. The defendant had a perfect right to employ whom it pleased, if it could. How did defendant intimidate or coerce? The complaint gives no answer. It will not be presumed that the threats, intimidation, or coercion complained of involved illegal acts. The law never presumes wrong, or crime, or illegality; it presumes always in favor of right and legal action. In the absence of any alleged wrongful act or threat, it would presume that defendant's interference was lawful and not unlawful. True, it is alleged that defendant, its officers, and agents unlawfully combined and confederated to destroy the union. But what is unlawful is a

question of law; whether a thing done is unlawful depends on what is done or threatened to be done. But what the defendant company, its officers, and agents combined or confederated to do in order to destroy the union is the precise thing the complaint fails to show. The court must always be able to look at the facts and say that if these facts are true they are illegal; otherwise there is no ground for invoking its protective agency.

The plaintiffs say defendant, its officers, and agents are seeking to prevent those discharged from obtaining employment as telegraphers. But how are they seeking to do so; what are they doing; are they doing acts that are unlawful? If so, what are they? The complaint gives no answer. There is no allegation in the complaint that there were any contractual relations between plaintiffs and the defendant company to retain plaintiffs in the service for any given period. But if there were, then it must be said that it was illegal to discharge them. Yet in that event equity can give no relief; the remedy is at law for a breach of contract, and each man injured must sue separately, and in his own right, for damages sustained. It would be intolerable if a man could be compelled to retain in his employ one he does not want; courts of equity exercise no such power and grant no such relief.

But it is said that defendant maintains a blacklist containing a list of names of such persons as may have incurred its displeasure and have been discharged from its service, and that, by methods not known to them, it prevents such discharged persons from getting employment as telegraph operators; that they have blacklisted people solely because they belong to the union, and that they intend to blacklist others for the same reason. We have seen that it is not unlawful to discharge plaintiffs because they belong to the union. Is it unlawful for defendant to keep a book showing that they were discharged and because they belonged to the union? The union presumably, and especially in view of the allegations in the bill, is an honorable, reputable, and useful organization, intended to better the conditions and elevate the character of its members. Is it illegal for defendant to keep a book showing that it had discharged members of such a union solely because they belong to it? That seems to be the real essence of the bill. Is it illegal to notify others that it keeps such a book and that they can inspect it, or to inform others what such a book shows? That seems to be the ground of complaint. There can be no question about it; the positive, direct, and unequivocal allegation is that

defendant keeps such a book; that plaintiffs are placed on it solely because they belong to the union. Can a court of equity grant relief to a man who says for his cause of action that he belongs to a reputable organization, and that he has been discharged solely because he did belong to it; that his employer who discharged him keeps a book on which is placed his name solely because he belonged to such organization; and that he gives that information to other persons, who refuse to employ him on that account? Suppose a man should file a bill allegating that he belonged to the Honorable and Ancient Order of Freemasons, or to the Presbyterian church, or to the Grand Army of the Republic; that his employer had discharged him solely on that account; that he had discharged others of his employees, and intended to discharge all of them, for the same reason; that he kept a book which contained all the names of such discharged persons, and set opposite the name of each discharged person the fact that he had been discharged solely on the ground that he belonged to such organization; and that he had given such information to others, who refused to employ such persons on that account. Is it possible a court of equity could grant relief? If so, pray, on what ground? And yet that is a perfectly parallel case to this as made by the bill.

Those who may be interested in the questions raised by the demurrer to this bill will be interested and instructed by reading the following cases, and especially the first: *Payne* v. *Western & Atlantic Railroad Co.*, 49 Am. Rep. 666; *Dina Worthington* v. *Waring*, 157 Mass. 421; *Hundley* v. *Louisville & Nashville Railway Co.*, 48 S.W. 429; *McDonald* v. *Illinois Central Railroad*, 187 Ill. 529; *Wabash Railroad Co.* v. *Hannahan*, 121 Fed. 563.

The demurrer is sustained from want of equity in the bill.

QUESTIONS

1. D employs P under an arrangement terminable at the will of either party. D discharges P because the latter joins a union. What decision in an action by P against D for damages?
2. D is under a contract to employ P for a year. Before the end of the year D discharges P because the latter joins a union. What decision in an action by P against D?
3. X, Y, Z, and others, shoe manufacturers, organize for their common protection. It is a rule of the association that each member will furnish to all other members a list of striking employees and it is understood that no member will employ any worker whose name appears on such a list. P, a striking employee, is refused employment by Z because of this understanding. What are P's rights, if any, and against whom?

4. It is further agreed by the members of the association that any member who employs a striking employee shall be expelled from the association or fined as the association may decide. P is refused employment by Y because of the operation of this rule. What are his rights, if any, and against whom?
5. The association further agrees that all members shall discharge any employee who joins a union after accepting employment and that any member who refuses to enforce this rule shall be expelled or fined. P is discharged by Z because of this rule. To what relief, if any, is P entitled?
6. X continues to employ union labor notwithstanding his expulsion from the association. The association thereupon notifies all wholesaler leather dealers that the patronage of all members of the association will be withdrawn if they do not cease selling materials to X. (*a*) To what relief, if any, is X entitled? (*b*) To what relief, if any, is P, union worker in X's employ, entitled?
7. Z's employees are on a strike for higher wages. (*a*) The association is attempting to dissuade merchants in the vicinity from selling goods to striking employees. (*b*) The association threatens to withdraw its patronage from such merchants unless they cease dealing with the striking employees. To what relief, if any, are the striking employees entitled?

LAWLOR *v.* LOEWE

235 United States Reports 522 (1915)

The facts in this case, which is commonly known as the *Danbury Hatters' Case*, involving the validity of a verdict for damages resulting from a combination and conspiracy in restraint of trade under section 7 of the Anti-trust Act, are stated in the opinion.

Mr. Alton B. Parker, with whom Mr. Frank L. Mulholland was on the brief, for plaintiffs in error: Since the defendants in this case, although members of local unions of hatters which were affiliated with the national organization known as the United Hatters of North America, did not participate in the acts of the officers and agents of the national association which are relied upon to establish the allegation of the complaint, they can be held liable only on the ground that they had knowledge of, and, having knowledge, acquiesced in, those acts; membership in a local union and the payment of dues are not alone sufficient to make the defendants liable for the unlawful acts of the officers and agents of the national association.

Mr. Walter Gordon Merritt and Mr. Daniel Davenport for defendants in error: The charge of the court to the effect that the individual defendants, members of the union, were liable under the

Sherman Anti-trust Act, if they knew, or ought to have known, or were in duty bound to know, that their union and its officers were engaged in the conspiracy to restrain the plaintiffs' interstate trade, was under the circumstances of the case correct. The defendants are liable under the rule of *respondeat superior*.

HOLMES, J. This is an action under the act[1] of July 2, 1890, c. 647, sec. 7, 26 Stat. 209, 210, for combination and conspiracy in restraint of commerce among the states, specifically directed against the plaintiffs (defendants in error), among others, and effectively carried out with the infliction of great damage. The declaration was held good on demurrer in *Loewe* v. *Lawlor*, 208 U.S. 274, where it will be found set forth at length. The substance of the charge is that the plaintiffs were hat manufacturers who employed non-union labor; that the defendants were members of the United Hatters of North America and also of the American Federation of Labor; that in pursuance of a general scheme to unionize the labor employed by manufacturers of fur hats (a purpose previously made effective against all but a few manufacturers), the defendants and other members of the United Hatters caused the American Federation of Labor to declare a boycott against the plaintiffs and against all hats sold by the plaintiffs to dealers in other states and against dealers who should deal in them; and that they carried out their plan with such success that they have restrained or destroyed the plaintiffs' commerce with other states. The case now has been tried, the plaintiffs have got a verdict and the judgment of the District Court has been affirmed by the Circuit Court of Appeals. 209 Fed. Rep. 721.

[1] SECTION 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal. Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

SEC. 4. The several Circuit Courts of the United States are hereby invested with jurisdiction to prevent and restrain violations of this act. . . . .

SEC. 7. Any person who shall be injured in his business or property by any other person or corporation by reason of anything forbidden or declared to be unlawful by this act, may sue therefor in any Circuit Court of the United States in the district in which the defendant resides or is found, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the costs of suit, including a reasonable attorney's fee.

The grounds for discussion under the statute that were not cut away by the decision upon the demurrer have been narrowed still further since the trial by the case of *Eastern States Retail Lumber Dealers' Association* v. *United States*, 234 U.S. 600. Whatever may be the law otherwise, that case establishes that, irrespective of compulsion or even agreement to observe its intimation, the circulation of a list of "unfair dealers," manifestly intended to put the ban upon those whose names appear therein, among an important body of possible customers combined with a view to joint action and in anticipation of such reports, is within the prohibitions of the Sherman Act if it is intended to restrain and restrains commerce among the states.

It requires more than the blindness of justice not to see that many branches of the United Hatters and the Federation of Labor, to both of which the defendants belonged, in pursuance of a plan emanating from headquarters, made use of such lists and of the primary and secondary boycott in their effort to subdue the plaintiffs to their demands. The union label was used and a strike of the plaintiffs' employees was ordered and carried out to the same end, and the purpose to break up the plaintiffs' commerce affected the quality of the acts. *Loewe* v. *Lawlor*, 208 U.S. 274, 299. We agree with the Circuit Court of Appeals that a combination and conspiracy forbidden by the statute were proved, and that the question is narrowed to the responsibility of the defendants for what was done by the sanction and procurement of the societies above named.

The court in substance instructed the jury that if these members paid their dues and continued to delegate authority to their officers unlawfully to interfere with the plaintiffs' interstate commerce in such circumstances that they knew or ought to have known, and such officers were warranted in the belief that they were acting in the matters within their delegated authority, then such members were jointly liable, and no others. It seems to us that this instruction sufficiently guarded the defendants' rights, and that the defendants got all that they were entitled to ask in not being held chargeable with knowledge as matter of law. It is a tax on credulity to ask anyone to believe that members of labor unions at that time did not know that the primary and secondary boycott and the use of the "We don't patronize" or "Unfair" list were means expected to be employed in the effort to unionize shops. Very possibly they were thought to be lawful. See *Gompers* v. *United States*, 233 U.S. 604. By the constitution of the United Hatters the directors are to use "all the means

within their power" to bring shops "not under jurisdiction" "into the trade." The by-laws provide a separate fund to be kept for strikes, lockouts, and agitation for the union label. Members are forbidden to sell non-union hats. The Federation of Labor with which the Hatters were affiliated had organization of labor for one of its objects, helped affiliated unions in trade disputes, and to that end, before the present trouble, had provided in its constitution for prosecuting and had prosecuted many what it called legal boycotts. Their conduct in this and former cases was made public especially among the members in every possible way. If the words of the documents on their face and without explanation did not authorize what was done, the evidence of what was done publicly and habitually showed their meaning and how they were interpreted. The jury could not but find that by the usage of the unions the acts complained of were authorized, and authorized without regard to their interference with commerce among the states. We think it unnecessary to repeat the evidence of the publicity of this particular struggle in the common newspapers and union prints, evidence that made it almost inconceivable that the defendants, all living in the neighborhood of the plaintiffs, did not know what was done in the specific case. If they did not know that, they were bound to know the constitutions of their societies, and at least well might be found to have known how the words of those constitutions had been construed in the act.

Judgment affirmed.

QUESTIONS

1. What was the decision of the court in *Loewe* v. *Lawlor*, 208 U.S. 274?
2. (*a*) D and others, employees of P, organize for the purpose of bettering their working conditions. (*b*) They leave P's employment in a body because P refuses to grant their requests for an increase of wages. (*c*) Two of their representatives peacefully picket P's place of business in an attempt to persuade other employees to join in the strike and to dissuade persons from accepting employment with P. Are D and others punishable under the Sherman Act for any of the foregoing acts?
3. D and others resort to force and threats of violence to prevent other persons from accepting employment with P. To what relief, if any, is P entitled under the Sherman Act?
4. (*a*) D and others attempt by persuasion to prevent persons from dealing with P. (*b*) They resort to force and threats of violence to prevent persons from dealing with P. (*c*) They circulate a list of "unfair employers" among possible customers of P with intent to prevent

them from dealing with P. To what relief, if any, is P entitled under the Sherman Act in each of the foregoing situations?

5. D and others notify X that his workers will be called out on a strike if he does not cease to deal with P. To what relief, if any, is P entitled under the Sherman Act?
6. What remedy or remedies has a person who is being injured by a combination or a conspiracy within the meaning of the Sherman Act?
7. What persons were being held liable for damages in the principal case? What justification is there for holding all of these defendants liable?

DUPLEX PRINTING COMPANY *v.* DEERING

254 United States Reports 443 (1921)

This was a suit in equity by the complaint for an injunction to restrain a course of conduct carried on by the defendants in maintaining a boycott against the products of the complainant's factory, in furtherance of an alleged conspiracy to injure and destroy its goodwill, trade, and business—especially to obstruct and destroy its interstate trade.

The complainant is a Michigan corporation and manufactures printing presses in that state. It employs about 200 machinists in its factory and about 50 office employees, traveling salesmen, and expert machinists or road men who supervise the erection of the presses for complainant's customers at their various places of business.

The defendants are Emil J. Deering and William Bramley, sued individually and as business agents of District No. 15 of the International Association of Machinists, and Michael T. Neyland, sued individua'ly and as business agent of Local Lodge No. 328 of the same association.

The comp'ainant conducts its business on the "open shop" policy. The individual defendants and the local organizations of which they are representatives are affiliated with the International Association of Machinists, an unincorporated association having a membership of more than 60,000; and are united in a combination, to which the International Association also is a party, having the object of forcing the complainant to unionize its factory and enforce the "closed shop," the eight-hour day, and the union scale of wages by means of interfering with and restraining its interstate trade in the sale and manufacture of presses.

The defendants, in establishing the boycott of complainant's goods, have warned customers that it would be better for them not to purchase, or having purchased not to instal, presses made by com-

plainant, and threatened them with loss in case they should do so; threatened customers with sympathetic strikes in other trades; notified a trucking company usually employed by customers to haul the presses not to do so and threatened it with trouble if it should; incited employees of the trucking company, and other men employed by customers of complainant, to strike against their respective employees in order to interfere with the hauling and installation of presses; notified repair shops not to make repairs on Duplex presses; coerced union men by threatening them with loss of union cards and with being blacklisted as "scabs" if they should assist in installing the presses; and resorted to a variety of other modes of preventing the sale of complainant's presses in and about New York and the delivery of them in interstate commerce, such as injuring and threatening to injure complainant's customers and prospective customers, and persons concerned in hauling, handling, or installing the presses.

The District Court, on final hearing, dismissed the bill, 247 Fed. Rep. 192; the Circuit Court of Appeals affirmed its decree, 252 Fed. Rep. 722; and the present appeal was taken.

PITNEY, J. That complainant's business of manufacturing printing presses and disposing of them in commerce is a property right, entitled to protection against unlawful injury or interference; that unrestrained access to the channels of interstate commerce is necessary for the successful conduct of the business; that a widespread combination exists, to which defendants and the associations represented by them are parties, to hinder and obstruct complainant's interstate trade and commerce by the means that have been indicated; and that as a result of it complainant has sustained damage to its interstate trade, and is threatened with further and irreparable loss and damage in the future, is proved by clear and undisputed evidence. Hence the right to an injunction is clear if the threatened loss is due to a violation of the Sherman Act as amended by the Clayton Act.

Looking first to the former act, the thing declared illegal by its first section is "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations." The accepted definition of a conspiracy is, a combination of two or more persons by concerted action to accomplish some purpose not in itself criminal or unlawful by criminal or unlawful means. *Pettibone* v. *United States*, 148 U.S. 197. If the purpose be unlawful it may not be carried out even by means that would otherwise be legal; and although the purpose be unlawful it may not be carried out by criminal or unlawful means.

The substance of the matters here complained of is an interference with complainant's interstate trade, intended to have coercive effect upon complainant, and produced by what is commonly known as a "secondary boycott," that is, a combination not merely to refrain from dealing with complainant, or to advise or by peaceful means persuade complainant's customers to refrain ("primary boycott"), but to exercise coercive pressure upon such customers, actual or prospective, in order to cause them to withhold or withdraw patronage from complainant through fear of loss or damage to themselves should they deal with it.

As we shall see, the recognized distinction between a primary and a secondary boycott is material to be considered upon the question of the proper construction of the Clayton Act. But, in determining the right to an injunction under that and the Sherman Act, it is of minor consequence whether either kind of boycott is lawful or unlawful at common law or under the statutes of particular states. Those acts, passed in the exercise of the power of Congress to regulate commerce among the states, are of paramount authority, and their prohibitions must be given full effect irrespective of whether the things prohibited are lawful or unlawful at common law or under local statutes.

In *Loewe* v. *Lawlor*, 208 U.S. 274, where there was an effort to compel plaintiffs to unionize their factory by preventing them from manufacturing articles intended for transportation beyond the state, and also by preventing vendees from reselling articles purchased from plaintiffs and negotiating with plaintiffs for further purchases, by means of a boycott of plaintiffs' products and of dealers who handled them, this court held that there was a conspiracy in restraint of trade actionable under section 7 of the Sherman Act.

In *Eastern States Retail Lumber Dealers' Association* v. *United States*, 234 U.S. 600, wholesale dealers were subjected to coercion merely through the circulation among retailers, who were members of the association, of information in the form of a kind of "blacklist," intended to influence the retailers to refrain from dealing with the listed wholesalers, and it was held that this constituted a violation of the Sherman Act. Referring to this decision, the court said, in *Lawlor* v. *Loewe*, 235 U.S. 522, 534:

> That case established that, irrespective of compulsion or even agreement to observe its intimation, the circulation of a list of "unfair dealers," manifestly intended to put the ban upon those whose names appear

therein, among an important body of possible customers combined with a view to joint action and in anticipation of such reports, is within the prohibitions of the Sherman Act if it is intended to restrain and restrains commerce among the states.

It is settled by these decisions that such a restraint produced by reasonable persuasion is as much within the prohibition as one accomplished by force or threats of force; and it is not to be justified by the fact that the participants in the combination or conspiracy may have some object beneficial to themselves or their associates which possibly they might have been at liberty to pursue in the absence of the statute.

Upon the question whether the provisions of the Clayton Act[1] forbade the grant of an injunction under the circumstances of the

[1] SEC. 6. That the labor of a human being is not a commodity or article of commerce. Nothing contained in the antitrust laws shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for the purposes of mutual help, and not having capital stock or conducted for profit, or to forbid or restrain individual members of such organizations from lawfully carrying out the legitimate objects thereof; nor shall such organizations, or the members thereof, be held or construed to be illegal combinations or conspiracies in restraint of trade, under the antitrust laws.

SEC. 20. That no restraining order or injunction shall be granted by any court of the United States, or a judge or the judges thereof, in any case between an employer and employees, or between employers and employees, or between employees, or between persons employed and persons seeking employment, involving, or growing out of, a dispute concerning terms or conditions of employment, unless necessary to prevent irreparable injury to property, or to a property right, of the party making the application, for which injury there is no adequate remedy at law, and such property or property right must be described with particularity in the application, which must be in writing and sworn to by the applicant or by his agent or attorney.

And no such restraining order or injunction shall prohibit any person or persons, whether singly or in concert, from terminating any relation of employment, or from ceasing to perform any work or labor, or from recommending, advising, or persuading others by peaceful means so to do; or from attending at any place where any such person or persons may lawfully be, for the purpose of peacefully obtaining or communicating information, or from peacefully persuading any person to work or abstain from working; or from ceasing to patronize or to employ any party to such dispute, or from recommending, advising, or persuading others by peaceful and lawful means so to do; or from paying or giving to, or withholding from, any person engaged in such dispute, any strike benefit or other moneys or things of value; or from peaceably assembling in a lawful manner, and for lawful purposes; or from doing any act or thing which might lawfully be done in the absence of such dispute by any party thereto; nor shall any of the acts specified in this paragraph be considered or held to be violations of any law of the United States.

present case, the Circuit Court of Appeals was divided; the majority holding that under section 20, "perhaps in conjunction with section 6," there could be no injunction. Defendants seek to derive from these sections some authority for their conduct. As to section 6, it seems to us its principal importance in this discussion is for what it does *not* authorize, and for the limit it sets to the immunity conferred. The section assumes the normal objects of a labor organization to be legitimate, and declares that nothing in the antitrust laws shall be constructed to forbid the existence and operation of such organizations or to forbid their members from *lawfully* carrying out their *legitimate* objects; and that such an organization shall not be held in itself—merely because of its existence and operation—to be an illegal combination or conspiracy in restraint of trade. But there is nothing in the section to exempt such an organization or its members from accountability where it or they depart from its normal and legitimate objects and engage in the actual combination or conspiracy in restraint of trade. And by no fair or permissible construction can it be taken as authorizing any activity otherwise unlawful, or enabling a normally lawful organization to become a cloak for an illegal combination or conspiracy in restraint of trade as defined by the antitrust laws.

The principal reliance is upon section 20. This regulates the granting of restraining orders and injunctions by the courts of the United States in a designated class of cases, with respect to (*a*) the terms and conditions of the relief and the practice to be pursued, and (*b*) the character of the acts that are to be exempted from the restraint; and in the concluding words it declares (*c*) that none of the acts specified shall be held to be violations of any law of the United States. All its provisions are subject to a general qualification respecting the nature of the controversy and the parties affected. It is to be a "case between an employer and employees, or between employers and employees, or betweeen employees, or between persons employed and persons seeking employment, involving, or growing out of, a dispute concerning terms or conditions of employment."

The first paragraph merely puts into statutory form familiar restrictions upon the granting of injunctions already established and of general applications in the equity practice of the courts of the United States. It is but declaratory of the law as it stood before. The second paragraph declares that "no *such* restraining order or injunction" shall prohibit certain conduct specified—manifestly still referring to a "case between an employer and employees, ...

involving, or growing out of, a dispute concerning terms or conditions of employment," as designated in the first paragraph. It is very clear that the restriction upon the use of the injunction is in favor only of those concerned as parties to such a dispute as is described. The words defining the permitted conduct include particular qualifications consistent with the general one respecting the nature of the case and dispute intended; and the concluding words, "nor shall any of the acts specified in this paragraph be considered or held to be violations of any law of the United States," are to be read in the light of the context, and mean only that those acts are not to be so held when committed by parties concerned in "a dispute concerning terms or conditions of employment." If the qualifying words are to have any effect, they must operate to confine the restriction upon granting of injunctions, and also the relaxation of the provisions of the antitrust and other laws of the United States, to parties standing in proximate relation to a controversy such as is particularly described.

The majority of the Circuit Court of Appeals appear to have entertained the view that the words "employers and employees" as used in section 20 should be treated as referring to "the business class or clan to which the parties litigant respectively belong"; and, as there had been a dispute at complainant's factory in Michigan concerning the conditions of employment there—a dispute created, it is said, if it did not exist before, by the act of the Machinists' Union in calling a strike at the factory—section 20 operated to permit members of the Machinists' Union elsewhere—some 60,000 in number—although standing in no relation of employment under complainant, past, present, or prospective, to make that dispute their own and proceed to instigate sympathetic strikes, picketing, and boycotting against employers wholly unconnected with complainant's factory and having relations with complainant only in the way of purchasing its product in the ordinary course of interstate commerce—and this where there was no dispute between such employers and their employees respecting terms or conditions of employment.

We deem this construction altogether inadmissable. Section 20 must be given full effect according to its terms as an expression of the purpose of Congress; but it must be borne in mind that the section imposes an exceptional and extraordinary restriction upon the equity powers of the courts of the United States and upon the general operation of the antitrust laws, a restriction in the nature of a

special privilege or immunity to a particular class, with corresponding detriment to the general public; and it would violate rules of statutory construction having general application and far-reaching importance to enlarge that special privilege by resorting to a loose construction of the section, not to speak of ignoring or slighting the qualifying words that are found in it. Full and fair effect will be given to every word if the exceptional privilege be confined—as the natural meaning of the words confines it—to those who are proximately and substantially concerned as parties to an actual dispute respecting the terms or conditions of their own employment, past, present, or prospective. The extensive construction adopted by the majority of the court below virtually ignores the effect of the qualifying words. Congress had in mind particular industrial controversies, not a general class war. "Terms or conditions of employment" are the only grounds of dispute recognized as adequate to bring into play the exemptions; and it would do violence to the guarded language employed were the exemption extended beyond the parties affected in a proximate and substantial, not merely a sentimental or sympathetic, sense by the cause of dispute.

Nor can section 20 be regarded as bringing in all members of a labor organization as parties to a "dispute concerning terms or conditions of employment" which proximately affects only a few of them, with the result of conferring upon any and all members—no matter how many thousands there may be, nor how remote from the actual conflict—those exemptions which Congress in terms conferred only upon parties to the dispute. That would enlarge by construction the provisions of section 20, which contains no mention of labor organizations, so as to produce an inconsistency with section 6, which deals specifically with the subject and must be deemed to express the measure and limit of the immunity intended by Congress to be incident to mere membership in such an organization. At the same time it would virtually repeal by implication the prohibition of the Sherman Act, so far as labor organizations are concerned, notwithstanding repeals by implication are not favored; and in effect, as was noted in *Loewe* v. *Lawlor*, 208 U.S. 274, 303–4, would confer upon voluntary associations of individuals formed within the states a control over commerce among the states that is denied to the governments of the states themselves.

The qualifying effect of the words descriptive of the nature of the dispute and the parties concerned is further borne out by the

phrases defining the conduct that is not to be subjected to injunction or treated as a violation of the laws of the United States, that is to say: (*a*) "terminating any relation of employment, ... or persuading others by peaceful and lawful means so to do"; (*b*) "attending at any place where any such person or persons may lawfully be, for the purpose of peacefully obtaining or communicating information, or from peacefully persuading any person to work or to abstain from working"; (*c*) "ceasing to patronize or to employ any party to such dispute, or . . . . recommending, advising, or persuading others by peaceful and lawful means so to do"; (*d*) "paying or giving to, or withholding from, any person engaged in such dispute, any strike benefits . . . ."; (*e*) "doing any act or thing which might lawfully be done in the absence of such dispute by any party thereto." The emphasis placed on the words "lawful" and "lawfully," "peaceful" and "peacefully," and the reference to the dispute and the parties to it, strongly rebut a legislative intent to confer a general immunity for conduct violative of the antitrust laws, or otherwise unlawful. The subject of boycott is dealt with specifically in the "ceasing to patronize" provision, and by the clear force of the language employed the exemption is limited to pressure exerted upon a "party to such dispute" by means of "peaceful and *lawful*" influence upon neutrals. There is nothing here to justify defendants or the organizations they represent in using either threats or persuasion to bring about strikes or a cessation of work on the part of employees of complainant's customers or prospective customers, or of the trucking company employed by the customers, with the object of compelling such customers to withdraw or refrain from commercial relations with complainant, and of thereby constraining complainant to yield their matter in dispute. To instigate a sympathetic strike in aid of a secondary boycott cannot be deemed "peaceful and lawful" persuasion. In essence it is a threat to inflict damage upon the immediate employer, between whom and his employees no dispute exists, in order to bring him against his will into a concerted plan to inflict damage upon another employer who is in dispute with his employees. The majority of the Circuit Court of Appeals, very properly treating the case as involving a secondary boycott, based the decision upon the view that it was the purpose of section 20 to legalize the secondary boycott "at least in so far as it rests on, or consists of, refusing to work for any one who deals with the principal offender." Characterizing the section as "blindly drawn," and con-

ceding that the meaning attributed to it was broad, the court referred to the legislative history of the enactment as a warrant for the construction adopted. Let us consider this.

By repeated decisions of this court it has come to be well established that the debates in Congress expressive of the views and motives of individual members are not a safe guide, and hence may not be resorted to, in ascertaining the meaning and purpose of the law-making body. *Aldridge* v. *Williams*, 3 How. 9, 24; *United States* v. *Union Pacific Railroad Co.*, 91 U.S. 72, 79. But reports of committees of House and Senate stand upon a more solid footing, and may be regarded as an exposition of the legislative intent in a case where otherwise the meaning of a statute is obscure. *Binns* v. *United States*, 194 U.S. 486, 495. And this has been extended to include explanatory statements in the nature of a supplemental report made by the committee member in charge of a bill in course of passage. *Binns* v. *United States*, *supra; Pennsylvania Railroad Co.* v. *International Coal Co.*, 230 U.S. 184, 198–99; *United States* v. *Coca Cola Co.*, 241 U.S. 265, 281; *United States* v. *St. Paul, Minneapolis & Manitoba Railway Co.*, 247 U.S. 310.

In the case of the Clayton Act, the printed committee reports are not explicit with respect to the meaning of the "ceasing to patronize" clause of what is now section 20. But they contain extracts from judicial opinions and a then recent textbook sustaining the "primary boycott," and expressing an adverse view as to the secondary or coercive boycott; and, on the whole, are far from manifesting a purpose to relax the prohibition against restraints of trade in favor of the secondary boycott.

Moreover, the report was supplemented in this regard by the spokesman of the House committee (Mr. Webb) who had the bill in charge when it was under consideration by the House. The question whether the bill legalized the secondary boycott having been raised, it was emphatically and unequivocally answered by him in the negative. The subject, he declared in substance or effect, was under consideration when the bill was framed, and the section as reported was carefully prepared with the settled purpose of excluding the secondary boycott and confining boycotting to the parties to the dispute, allowing parties to cease to patronize and to ask others to cease to patronize a party to the dispute; it was the opinion of the committee that it did not legalize the secondary boycott, it was not their purpose to authorize such a boycott, not a member of the com-

mittee would vote to do so; clarifying amendment was unnecessary; the section as reported expressed the real purpose so well that it could not be tortured into a meaning authorizing the secondary boycott. This was the final word of the House committee on the subject, and was uttered under such circumstances and with such impressive emphasis that it is not going too far to say that except for this exposition of the meaning of the section it would not have been enacted in the form in which it was reported. In substantially that form it became law; and since in our opinion its proper construction is entirely in accord with its purpose as thus declared, little need be added.

The extreme and harmful consequences of the construction adopted in the court below are not to be ignored. The present case furnishes an apt and convincing example. An ordinary controversy in a manufacturing establishment, said to concern the terms or conditions of employment there, has been held a sufficient occasion for imposing a general embargo upon the products of the establishment and a nation-wide blockade of the channels of interstate commerce against them, carried out by inciting sympathetic strikes and a secondary boycott against complainant's customers, to the great and incalculable damage of many innocent people far remote from any connection with or control over the original and actual dispute—people constituting, indeed, the general public upon whom the cost must ultimately fall, and whose vital interest in unobstructed commerce constituted the prime and paramount concern of Congress in enacting the anti-trust laws, of which the section under consideration forms after all a part.

Reaching the conclusion, as we do, that complainant has a clear right to an injunction under the Sherman Act as amended by the Clayton Act, it becomes unnecessary to consider whether a like result would follow under the common law or local statutes, there being no suggestion that relief thereunder could be broader than that to which complainant is entitled under the acts of Congress.

There should be an injunction against defendants and the associations represented by them, and all members of those associations, restraining them, according to the prayer of the bill, from interfering or attempting to interfere with the sale, transportation, or delivery in interstate commerce of any printing press or presses manufactured by complainant, or the transportation, carting, installation, use, operation, exhibition, display, or repairing of any such press or presses,

or the performance of any contract or contracts made by complainant respecting the sale, transportation, delivery, or installation of any such press or presses, by causing or threatening to cause loss, damage, trouble, or inconvenience to any person, firm, or corporation concerned in the purchase, transportation, carting, installation, use, operation, exhibition, display, or repairing of any such press or presses, or the performance of any such contract or contracts; and also and especially from using any force, threats, command, direction, or even persuasion with the object or having the effect of causing any person or persons to decline employment, cease employment, or not seek employment, or to refrain from work or cease working under any person, firm, or corporation being a purchaser or prospective purchaser of any printing press or presses from complainant, or engaged in hauling, carting, delivering, installing, handling, using, operating, or repairing any such press or presses for any customer of complainant. Other threatened conduct by defendants or the associations they represent, or the members of such associations, in furtherance of the secondary boycott should be included in the injunction according to the proofs.

Decree reversed, and the cause remanded to the District Court for further proceedings in conformity with this opinion.

Justices Brandeis, Clarke, and Holmes, dissenting.

QUESTIONS

1. Would the court have reached a different conclusion in *Lawlor* v. *Loewe*, *supra*, page 264, if the case had arisen after the passage of the Clayton Act?
2. What reasons induced Congress to pass the Clayton Law?
3. Does the Clayton Act change the common law as to the legality of bargaining practices in labor controversies or is it simply designed to control the use of the writ of injunction?
4. Under the provisions of this law, when is the writ of injunction an appropriate remedy in a labor controversy?
5. By what process of reasoning did the court in the principal case arrive at the conclusion that the complainant was entitled to an injunction notwithstanding the provisions of the Clayton Act?

LAW AND THE FORM OF THE BUSINESS UNIT

CHAPTER I

INTRODUCTORY TOPICS

The final topic for consideration in this study deals with the legal aspects of the business unit. The business man, in choosing the form of unit in which he will carry on his business, in organizing, financing, managing, and dissolving it, and in meeting its various responsibilities to its members and to third persons, will encounter many legal problems. Some understanding of these legal problems will greatly assist the business manager in performing his various duties in connection with the business unit.

What is the most appropriate unit in which to carry on a given business, is a question which sooner or later comes to every business man. Shall he conduct his business as an individual enterpriser? Shall he appoint agents and delegate to them a part of his duties in carrying on the business? Shall he associate with himself others as joint-principals? Shall he organize his business and conduct it in corporate form? Or shall he resort to some other organization device? Organization devices, just as all other social and economic institutions, originate and develop in response to social and economic needs. The various types of business units to which reference has been made have developed and are continuing to develop in terms of business demands. There is, therefore, in the nature of things, no hard-and-fast rule for determining what is the most appropriate unit for a given business. What is appropriate for one business may be quite inappropriate for another. The question of the appropriateness of the business unit must be answered, in the first place, in terms of the nature, size, and peculiar needs of a given business; it must be answered, in the second place, in terms of the nature and characteristics of the various forms of the business unit. In other words, the problem is to discover the form of the unit which most nearly fits the particular business, and the solution of this problem necessitates an understanding both of the needs of the business and of the advantages and disadvantages of the various organization devices. Is the business one which demands close personal relations? Are the primary considerations economy and simplicity in organization? Is the business one which demands more capital than a private individual can ordinarily

provide? Is it a business which demands a large amount of capital? Is it a speculative or hazardous business in the conduct of which it is desirable to limit the liability of its proprietors? Is it a business in which management plays a large part? Is the business one which requires a fairly permanent and certain existence? These are typical of the questions which the business man must ask in determining the fitness of a given organization device for a given business and can only be answered in terms of the legal characteristics and attributes of the various forms of the business unit to which he can resort.

Assuming that the business man has decided upon the form of unit in which he will carry on his business, his next problem is to organize his business in terms of that form of unit. In some cases he will have to comply with definite, formal requirements; in other cases he may encounter no formal requirements at all. In any event, however, whether required by law or not, there are certain precautionary steps in organization which he should take to safeguard the rights of different parties. What must he do to protect his own interests? What should he do to safeguard the interests of his business associates? What should he do to protect the interests of the persons who will deal with the unit? What are the legal consequences which attach to his failure to make adequate provisions for the protection of these interested parties?

Prior or subsequent to, or contemporaneous with, the organization of the unit will come questions relating to the best method or methods of financing the business. The business man will discover that different considerations apply in financing a business, depending upon the particular organization device which has been selected. He will, therefore, want to know, in terms of the form of unit which he has chosen, what are the most efficient legal devices to which he can resort in raising capital; how these devices can best be utilized; what pitfalls he should watch for and what safe-guards he can establish in utilizing these devices; and what inducements, peculiar to the unit which he has chosen, he can offer to prospective investors.

After the business unit has been organized and financed arises the problem of managing the unit from day to day, the most important of all the problems in connection with the business unit from the point of view of the business manager. In the first place, he will find that one of his chief tasks is to keep the unit within the scope of its powers. He will, therefore, need to know what powers the unit enjoys and can exercise; and what legal consequences follow from exceeding its powers. In the second place, he will find that another

of his tasks is to see that the unit exercises its power in the authorized manner. He will, therefore, need to know how the powers of the unit are to be exercised. By whom, for instance, are the affairs of a given unit to be managed? How far can the majority go in conducting the business to suit themselves? How far can the minority object to the plans and policies of the majority? What are the appropriate remedies of the minority in case the majority are overreaching the minority in the management of the unit? What are the duties of the officers and agents of the unit to the unit and to the members of the unit? What are the duties of the members of the unit to the unit and to each other?

In carrying on the business, the unit through its officers and agents may do wrongs of one kind or another and perhaps commit crimes. Who is to be held responsible for these wrongs and crimes? Is the unit itself solely responsible for them? Are the officers and agents of the unit solely responsible for them? Are the members of the unit responsible? Are they all jointly responsible?

In the course of its business the unit will incur debts from time to time. Those responsible for the management of the unit will need to know what powers creditors have to subject the property of the unit and its members to the payment of these debts. Are creditors limited to the property of the unit in securing satisfaction of their claims? May they proceed against the property of the individual members of the unit? Or may the creditors proceed against the property of either at their pleasure?

Important questions arise with reference to the dissolution or termination of the business unit. How long does a given unit have the power to exist? Can the state in any manner terminate the relation before its allotted time? Can individual members bring it to an end prematurely? Can a majority of the members terminate the unit without the consent of the minority? Assuming that in one way or another the unit has been dissolved, what are the consequences of dissolution? What becomes of the liabilities of the unit? What becomes of its property?

The foregoing comments and questions indicate in broad outline the scope of our study of the legal aspects of the form of the business unit. The treatment of these different problems must necessarily be brief because of limitations of space and time. It is hoped, however, that the materials to follow, which are arranged in terms of this outline, will give some appreciation of the legal aspects of the business man's relation to the form of his business unit.

CHAPTER II

NATURE AND CHARACTERISTICS OF FORMS OF THE BUSINESS UNIT

PRATT *v.* BACON

10 Pickering's Massachusetts Reports 123 (1830)

PER CURIAM. There is certainly some resemblance between a corporation and a partnership, inasmuch as each may consist of two or more persons associated together, and acting in concert, for the promotion of some private or public object. But the difference between the relative rights and duties, the legal qualities and characteristics of the members of a manufacturing corporation, and copartners and tenants in common, is obvious and strongly marked. A corporation is an ideal body, subsisting only in contemplation of law, which may be composed of members constantly changing, which is deemed, for useful purposes, to have an existence independently of that of all the members of which it is composed, to be capable of perpetual succession, and of acquiring, holding, and conveying property. Its real and personal property is deemed to be vested in the corporation and not in the individuals composing it; and these have no other interest in it, or control over it, than the qualified ones, of electing officers, and receiving dividends and profits in the manner provided by the act of incorporation, or the votes and by-laws, which may be made pursuant to the powers conferred by it. They cannot bind their associates, or the corporation, either in any personal obligation, or executory contract, nor alienate, pledge, or otherwise affect the corporate property, by any sale, mortgage, contract, or other personal act. They may change their relation to the corporation, at any time, by a sale of their shares; and such sale is not deemed to be a transfer of any legal interest in the corporate property, but of the qualified, beneficial interest before mentioned. By a like transfer of shares, strangers may become members without the consent of the corporation, unless when some restraint is imposed upon the general right by a by-law; and such by-law, by imposing a particular limitation, would itself imply the existence of the general rule. It is true that at the time this corporation was established, by force of a

particular provision of law, the individual members were made conditionally liable for the debts of the corporation; but as the law then stood, this liability ceased by their ceasing to be members, by a sale of their shares, even for debts and obligations incurred while they were members, contrary to the well-known rule of law in relation to partners. But further, this liability was several and joint; it was provisional and collateral, in the nature of a guaranty, not the debt or obligation of the corporators themselves personally; it resulted from the positive provision of the statute, and not from the common law obligation of a contract deemed to be made by them and growing out of the relation in which they were placed. In all these respects the members of a manufacturing corporation, in their legal relation to each other, differ essentially and radically from partners, joint-tenants and tenants in common.

QUESTIONS

1. What is a corporation? What is the difference between a sole corporation and an aggregate corporation? between a public corporation and a private corporation? between a stock corporation and a non-stock corporation?
2. Draw up in outline form the outstanding differences between a corporation and a partnership.
3. What is meant by the statement that a corporation is a statutory body and that a partnership is a common-law body?
4. What is meant by the statement that a corporation enjoys perpetual succession? Does a partnership possess this characteristic?
5. What is the effect on the corporation of a transfer of his stock by a stockholder? What is the effect on a partnership of a transfer of his interest by a partner?
6. What is meant by the statement that a corporation is a legal entity and that a partnership is a mere group of individuals acting collectively? Point out some of the implications of this statement.
7. Which is the more restricted by state control in its activities, the corporation or the partnership? What practical difference does it make whether the one or the other is more frequently the subject of state control?

LIVERPOOL INSURANCE COMPANY *v.* MASSACHUSETTS

10 Wallace's United States Reports 566 (1870)

MILLER, J. The institution now known as the Liverpool and London Life and Fire Insurance Co., doing an immense business in England and in this country, was first organized at Liverpool by

what is there called a deed of settlement, and would here be called articles of association.

It will be seen by reference to the powers of the association, as organized under the deed of settlement, legalized and enlarged by acts of Parliament, that it possesses many, if not all, the attributes generally found in corporations for pecuniary profit, which are deemed essential to their corporate character.

1. It has a distinctive and artificial name by which it can make contracts.

2. It has a statutory provision by which it can sue and be sued in the name of one of its officers as the representative of the whole body, which is bound by the judgment rendered in such suit.

3. It has provision for perpetual succession by the transfer and transmission of the shares of its capital stock, whereby new members are introduced in place of those who die or sell out.

4. Its existence as an entity apart from the shareholders is recognized by the act of Parliament which enables it to sue its shareholders and to be sued by them.

Most of the states of the Union have general laws by which persons associating themselves together, as the shareholders in this company have done, become a corporation.

It is objected that the association is nothing but a partnership, because its members are liable individually for the debts of the company. But however the law on this subject may be held in England, it is quite certain that the principle of personal liability of the shareholders attaches to a very large proportion of the corporations of this country, and it is a principle which has warm advocates for its universal application when the organization is for pecuniary profit.

It is also urged that the several acts of Parliament we have mentioned expressly declare that they shall not be held to constitute the body of a corporation.

But whatever may be the effect of such a declaration in the courts of that country, it cannot alter the essential nature of a corporation or prevent the courts of another jurisdiction from inquiring into its true character, whenever they may come in issue.

The question before us is whether an association, such as the one we are considering, in attempting to carry on its business in a manner which requires corporate powers under legislative sanction, can claim, in a jurisdiction foreign to the one which gave those powers, that it is only a partnership.

We have no hesitation in holding that, as the law of corporations is understood in this country, the association is a corporation, and that the law of Massachusetts, which only permits it to exercise its corporate function in that state on the condition of payment of a specific tax, is no violation of the federal constitution or of any treaty protected by said constitution.

BRADLEY, J. (Dissenting.) While I agree in the result which the court has reached, I differ from it on the question whether the company is a corporation. I think it is one of those special partnerships which are called joint-stock companies, well known in England for nearly a century, and cannot maintain an action or be sued as a corporation in this country without legislative aid. But as it is a company associated under the laws of a foreign country, it comes within the scope of the Massachusetts statute, and cannot claim exemption from its operation for the causes alleged in that behalf. It could not have been the intent of the treaty of 1815 to prevent the States from imposing taxes or license laws upon either British corporations or joint-stock companies desiring to establish banking or insurance business therein. And certainly these companies cannot be exempted from such laws on the ground that citizens have chosen to take some of their shares.

QUESTIONS

1. What was the association under consideration in this case? In what respect did it resemble a corporation? a partnership? What practical difference did it make whether it was the one or the other?
2. What is a joint-stock company? How does it differ from a corporation? from a partnership?
3. The legislature of a certain state provides that two or more persons, upon the taking of certain prescribed steps, may associate themselves together in a common business; that the association may have a common name in which it may contract, receive, hold and transfer property, sue and be sued. Is this a corporation? Is it a partnership?
4. The legislature provides further that the death of a member of the association shall not work a dissolution of the organization; and that its capital may be divided into transferable shares. Is this a corporation? Is it a partnership?
5. The legislature provides, in addition to the foregoing, that the individual property of the members of the association shall not be liable for the debts of the association until the assets of the association have been exhausted. Is this a corporation or a partnership?

BURT *v.* LATHROP

52 Michigan Reports 106 (1883)

CAMPBELL, J. Plaintiff sued a large number of defendants as jointly liable to him for his services as attorney in defending some patent suits concerning the right to use certain hard-rubber material in dentistry. He declared specially and with the common counts for these services, and also set up two judgments rendered in Jackson County for the same causes of action. Upon trial the court below ordered a verdict for defendants.

The counts which described the judgments do not set them out in such a way as to make out any legal liability under them against all these defendants, and the proofs are not any more definite. It appears affirmatively that no jurisdiction existed to bind more than a part of them, and there can be nothing claimed for them under the issue as presented. They may, therefore, be laid aside.

The ground for asserting a claim against the defendants jointly is that they are claimed to have become members of an association combined for the purpose of legal resistance to the claims of the patentee, and that plaintiff was employed by their officers.

There is no testimony tending to show any immediate personal employment of plaintiff by the defendants, jointly or individually, so as to justify this joint action. But it was claimed that they stood on the footing of partners bound by the action of their designated managing members.

The testimony indicates that several of the defendants, at various times, became members of an association which, so far as pertinent to this inquiry, required them to pay five dollars each into the treasury and to pay such assessments as should be levied pro rata, on pain of being left out of the association and its privileges. The officers were to employ counsel, and money was to be paid on the order of the president and secretary.

We can find in this arrangement nothing analogous to a partnership. There was no common business and nothing involving profit and loss in a business sense. No one was empowered to make contracts binding on the subscribers personally, and no one was to be liable except for assessments nor even for those except as he saw fit to pay them to keep his membership. It was nothing more than a combination which may have made the parties in some respects responsible to each other, but which did not, we think, authorize any contract

with third persons which should bind any member personally beyond his assessments. As plaintiff was not only aware of the articles but showed that he acted under them and in furtherance of them in various ways, no question arises in the nature of an equitable estoppel.

We are not concerned on this record to consider whether plaintiff has any other adequate means of securing compensation. The only question now is whether these defendants are his joint debtors. We think they are not.

Judgment affirmed.

QUESTIONS

1. Do you conclude from the decision in this case that the plaintiff has no remedy against the defendants?
2. An action was brought against a large number of persons, members of a masonic lodge, to hold them liable as partners upon a certificate of indebtedness, executed by the master and wardens of the lodge for a debt incurred in the erection of a lodge building. The lodge was organized for charitable, benevolent, and social purposes. What decision in the action?
3. How would you define a partnership? Distinguish it from the relation of principal and agent.
4. Can there be such an organization as a non-profit corporation?

WHITE *v.* EISEMAN

134 New York Reports 101 (1892)

APPEAL from judgment of the General Term of the Supreme Court in the first judicial department, entered upon an order made December 31, 1890, which overruled defendants' exceptions, denied their motion for a new trial and ordered judgment for plaintiffs on a verdict directed by the court.

This action was brought to recover from the defendants, as general partners composing the firm of Spencer & Perkins, a demand of the plaintiffs against that firm for goods sold and delivered.

The defendants, Samuel and Moses Eiseman, alleged in their answer that said firm was a limited partnership, composed of themselves as special partners and of Sidney S. Spencer and George E. Perkins as general partners.

On the trial it appeared that a certificate of limited partnership, in the usual form, was signed and acknowledged by the general and special partners on the third of August, 1886. On the same day the

special partners delivered to said Spencer their check of even date on a solvent bank, payable to the order of Spencer & Perkins, for $10,000, the amount of their contribution toward the common stock, as stated in the certificate. Samuel Eiseman signed the check, deducted the amount thereof from the balance that he and Moses Eiseman then had on deposit in the bank and it was charged to them on their bank book when balanced on the following day. The check was duly certified by the bank August 4, and deposited to the credit of the firm August 5 at 2:00 P.M., on which day at 4:45 P.M., the certificate and affidavit were filed. The check was paid on the sixth of August to the bank in which it had been deposited. The affidavit was made August 3, the day that the jurat bears date, by Mr. Spencer, who stated therein "that the sum specified in said certificate to have been contributed by the special partners to the common stock has been actually and in good faith paid in cash."

At the close of the evidence the court directed a verdict in favor of the plaintiffs for the amount claimed and the exception of the defendants, Samuel and Moses Eiseman, to such direction was overruled by the General Term and a judgment directed on the verdict, one of the justices dissenting.

VANN, J. The primary object of the act authorizing limited partnerships was to encourage those having capital to become partners with those having skill, by limiting the liability of the former to the amount actually contributed to the firm. The next and incidental object was to furnish reasonable protection to those dealing with the concern by requiring certain acts to be done and public notice thereof given, so that all who desired might know the essential features of the arrangement. In order to prevent evasion and fraud, it was provided that any false statement in the certificate of affidavit should render all the partners equally liable. That provision, however, was not designed as a trap to catch the innocent and unwary, but as a bar to shut out the dishonest and fraudulent. While the courts were at first inclined to a strict construction against those thus seeking exemption from the common-law liability of partners, the tendency in this state is now toward a liberal construction, so as to accomplish the wise purpose of the act by uniting capital and labor in business enterprises, without excessive hazard to the former.

The more recent cases regard the statute as remedial in nature, and, looking to substance rather than form, protect those who, in good faith, substantially comply with the essential requirements.

We now have a case before us where nothing of substance was omitted. The defect complained of neither misled nor injured the creditors who seek to take advantage of it. Payment having been made in the usual way practiced by business men, who regard a check with adequate funds behind it as cash, an affidavit was made accordingly, and the good faith of the affiant is questioned by no one. There was no intentional violation of the statute, and the failure in literal compliance consisted of the fact that the affidavit was not technically true when made, although both affidavit and certificate were true when filed. The exact question, therefore, presented for decision is whether there is substantial compliance, if the affidavit and certificate are true when, for the first time, use is made of them for a purpose contemplated by the statute?

The organization of the firm is completed by the filing of these papers, for the omission of the clerk to record was held in the case last cited not to affect the liability of the special partner. The date of this culminating act, therefore, is of the highest consequence, because it is the time when the firm becomes ready for business, and when the safeguards should exist that are designed to protect third parties. As was well said in a recent case:

> It is the act of filing the certificate and affidavit which gives life to the partnership and confers immunity for the debts of the firm upon the special partner, and from that moment those who deal with the partnership become entitled to know the truth as to its formation, and from and after that time a wrong is done to those who deal with it, if a false statement is published through the filing of the certificate. The truth of the statements contained in the certificate is to be determined, therefore, at the time of its being filed with the county clerk. If true at the instant of filing, there is no liability, because, being true at the instant of the creation of the limited partnership, they fulfill the purpose for which the law was enacted. [*Ropes v. Colgate*, 17 Abb. [N.C.], 136.]

We adopt this language as applicable to the case in hand, and extend it, in view of the circumstances already stated, to the affidavit filed with the certificate. In reaching this conclusion, we are guided by the object of the legislature in passing the statute, which should not be defeated by exalting the letter and subverting the spirit. The formation of limited partnerships should not be made difficult or dangerous by technical construction. If every statement contained in the papers required to be filed is true at the time of filing, nothing further is necessary for the protection of creditors, who are

thus given all the information that it was the policy of the statute to furnish. More than this should not be exacted in the absence of an actual intent to deceive. As the special partner cannot make the affidavit himself (sec. 7), he should be protected if it is true when filed, as that is the first use that is made of it, and the occasion when he is first charged with the duty of examining it. It is then that it becomes material and then that it must be true, at the peril of general liability if it is untrue. If upon then examining it he found its contents were true, it would be a harsh and unreasonable rule to require him to ascertain, if he could, the precise date when the check was cashed or certified, and comparing it with the date of the jurat, to decide, at the peril of losing all he had, which date preceded the other. The affidavit is simply evidence of the facts therein stated, and if those facts are true when such evidence is first used, the statute is satisfied, unless some furtive purpose existed when the verification was made. If any business had been done between the making and filing, or if it had been a mere artifice to evade the statute, or if any creditor had been misled by the technical inaccuracy of statement, when viewed from the date of the jurat, a different question would have been presented from that now before us.

Our reasons for holding that the affidavit was true when filed may be stated in a few words. The check was delivered to the general partners on the third, certified on the fourth, deposited to the credit of the firm on the fifth, before the papers were filed, but was not paid to the bank where it was deposited until the sixth.

The general rule relating to payment of capital by the special partner, as stated by Mr. Bates in his work on *Limited Partnerships*, section 45, is that "the fund must be in existence in money and in the sole control of the general partner on the day the partnership is formed, free from all contingencies except those arising from the proper business of the concern." This is in substantial accord with the authorities, which hold that payment in goods, notes, or even government bonds, worth more than par, is insufficient.

We think that where the money is actually in the bank to the credit of the special partner, and he gives absolute and final control of it to the general partner, it should be regarded as a payment in cash. The delivery of a certified check to the payee has this effect. (*Clewes* v. *Bank of New York, etc.*, 89 N.Y. 418; *Meads* v. *Merchants' Bank of Albany*, 25 *id.* 143; *Farmers and Mechanics' Bank* v. *Butchers and Drovers' Bank*, 16 N.Y. 125.)

While the check in question was delivered by the special partner on the third without certification, it was presented to the bank by the general partner on the fourth, and certified while in his hands. In other words, when it was in his power to obtain cash on the check, he procured it to be certified instead of paid, which, as between the firm and the special partner, was a payment, and discharged the latter from liability on the check. (*First National Bank of Jersey City* v. *Leach*, 52 N.Y. 350.) On the same day the bank charged the amount of the check to the special partners on their bank book and deducted it from the balance to their credit. Thus the special partners lost control of the money, the general partners obtained control of it, and there was an absolute, final, irrevocable appropriation of it to the use of the firm on the fourth, or the day before the certificate and affidavit were filed.

We think that the exception taken by the defendants requires a new trial.

Judgment reversed.

QUESTIONS

1. What was the organization under consideration in the principal case? How does it differ from an ordinary partnership? from a joint-stock company? from a partnership?
2. What is the purpose of legislation creating limited partnerships? How are the provisions of such legislation usually construed?
3. A, B, and C, trustees, organize a realty trust company for the purpose of investing and reinvesting money for profit in real estate. They receive money from various contributors to be held in trust for the purpose mentioned and issue to them certificates of shares in the trust. By the declaration of trust, which the trustees sign, the management of the affairs of the business is vested absolutely in the trustees; the trustees are self-perpetuating; they are to pay dividends to the owners of the shares when they see fit; the trustees are responsible for the debts of the concern to the extent of the trust fund, but neither trustees nor contributors are personally responsible for such debts; the shares in the trust fund are transferable by their owners with certain named restrictions. (*a*) What kind of business organization is this? (*b*) Discuss its legality.

HENDREN *v.* WING

60 Arkansas Reports 561 (1895)

Riddick, J. The Arkansas Machinery & Supply Co. is not a corporation, but it is the business name of a firm of partners. The question for us to determine is whether a chattel mortgage, executed

to it as such partnership, is valid at law. The decisions in regard to transfers of real estate to partnerships are based on the old rule that "a partnership, as such, cannot at law be the grantee in a deed, or hold real estate." *Percifull* v. *Platt*, 36 Ark. 464. This rule does not apply to personal property. On the contrary, a partnership, as such, can at law be the vendee in a bill of sale or other conveyance of personal property. The custom of the country teaches us that this is so. The business of the country is largely carried on by partners under partnership names, which frequently do not contain the name of any person. Vast quantities of personal property of all kinds are contracted for, bought, and sold by such firms under their firm names each year, and their right thus to buy and sell goes unchallenged. A consideration of this fact shows that there is a wide distinction between the rights of partnerships at law in regard to the buying and selling of personal property and the restrictions which prevail there in regard to transfers of real estate.

A mortgage is only a conveyance for the purpose of securing a debt. If a bill of sale conveying personal property to a partnership by its firm name is valid, we see no reason why a mortgage of personal property to a partnership should not be upheld under like circumstances. It is true that the statute requires certain formalities in regard to acknowledging and recording mortgages in order to give notice to third parties. But there is nothing in the statute which renders invalid mortgages of personal property executed to a partnership in its firm name. Such a conveyance to a firm is just as effectual as if the name of each partner had been set out in the mortgage. *Henderson* v. *Gates*, 52 Ark. 371; *Kellogg* v. *Olsen*, 34 Minn. 103; *Byam* v. *Bickford*, 140 Mass. 32; *Brunson* v. *Morgan*, 76 Ala. 593; *Chicago Lumber Co.* v. *Ashworth*, 26 Kas. 212.

We therefore conclude that the judgment of the circuit court in regard to the validity of the mortgage was correct, and it is affirmed.

QUESTIONS

1. What was the issue under consideration in this case? How was it decided? What rule of law can be deduced from the decision?
2. Would the decision have been the same in this case if the mortgage in question had been a mortgage upon the firm realty?
3. A and B are partners doing business under the firm name of the A Company. They buy wheat in the firm name for the firm. Is the transaction valid? To whom does title to the wheat pass?

4. A and B are carrying on a partnership business under the firm name of the Southside Express Co. They buy a horse with firm money for firm uses. Is the transaction valid? To whom does title to the horse pass?

WOODWARD *v.* McADAM

101 California Reports 438 (1894)

PATERSON, J. This is an action on a negotiable promissory note secured by a mortgage given by the defendant McAdam to Shoobert, Beale & Co., and by the latter assigned to this plaintiff. The court below granted a decree of foreclosure as prayed for, and from such decree the defendant Jackson, who is a grantee for value by deed from McAdam given subsequent to the mortgage, has appealed.

The point made is that the mortgagee is a fictitious person—that the mortgage having been made to a partnership doing business under a fictitious name, creates at most only an equity, and as against a subsequent grantee for value of the mortgagor establishes no lien.

There is no doubt that a partnership is not a person, either natural or artificial, and it cannot at law be the grantee in a deed or hold real estate. Legal title must vest in some person, but if the title be made to all the partners by name, they hold the legal title as tenants in common. In equity, however, a different rule prevails. There the real purpose for which the property was acquired is considered, and under the principles of trusts the court will regard real estate held for partnership purposes as personal property, so far as such holding may be necessary to settle the equities between a firm and its creditors, or between the partners themselves. None of the latter principles is involved in this action, however.

If the name of the grantee were purely fictitious, that is, if no person were named, it may be that the mortgage would be void, although there is respectable authority for holding that a mortgage may be enforced in the firm name. (*Foster* v. *Johnson*, 39 Minn. 380.) In the case at bar the names of two of the partners appear in the firm name. There is an important distinction to be drawn between a description which is inherently uncertain and indeterminate and one which is merely imperfect and capable of different applications.

To correct the one is, in effect, to add new terms to the instrument; while to complete the other is only to ascertain and fix the application of terms already contained in it. Indeed, the most usual and perfect description of the grantee—that which gives his Christian and surname, and the town in which he lives—may prove to be imperfect, as others bearing both

those names may be living in the same town. And if the Christian name or place of residence be omitted the description is only rendered the more imperfect; it is less certain than it might be, and usually is, made. But a grantee is still designated, though imperfectly, and for aught that the deed discloses the party accepting the conveyance may be the only person answering the description given. In all these cases a resort to extraneous facts and circumstances may become necessary, in order to ascertain the individual to whom the description was intended to apply; but it is not perceived that the greater or less probability of this should, in either case, affect the validity of the deed. [*Morse* v. *Carpenter*, 19 Vt. 616.]

In *Moreau* v. *Saffarans*, 3 Sneed, 599, 67 Am. Dec. 582, it was held that real estate purchased by partners is to be regarded in respect to the legal title as an estate held by them as tenants in common, but subject to a trust for the benefit of the partnership until the partnership accounts are settled, and that a conveyance to "J. L. Saffarans & Co." would operate to invest John L. Saffarans, individually, with the entire legal title, but that in equity he would be treated as holding the legal title in trust for the benefit of the partnership. In *Menage* v. *Burke*, 43 Minn. 212, the court sustained a mortgage of real estate to "Farnham and Lovejoy," as legally sufficient as a mortgage to Sumner W. Farnham and James A. Lovejoy, it appearing that said persons constituted the firm of Farnham and Lovejoy. In *Foster* v. *Johnson*, 39 Minn. 380, the court explained *Tidd* v. *Rines*, 26 Minn. 201, cited by appellant, and held that in an action to foreclose a mortgage it was no objection that the mortgage ran to a partnership in its firm name. In *Holmes* v. *Jarrett, Moon & Co.* 7 Heisk, 506, the court held that where the deed was made to Jarrett, Moon & Co., and it did not appear whether the firm was composed of Jarrett, Moon and others, or Jarrett Moon and others, in trust for the partnership, and that the uncertainty arising from the omission of the Christian names of the grantees could be removed by parol proof. (See also, *Brunson* v. *Morgan*, 76 Ala. 594.) In *Winter* v. *Stock*, 29 Cal. 407, 89 Am. Dec. 57, it was held that a conveyance of land to L. B. & Co. vests the legal title of the same in L. B. alone, and that his deed would give to his grantee a good and valid title.

The judgment is affirmed.

QUESTIONS

1. How did the controversy arise in this case? What issue was presented for decision? How was it decided?
2. A, B, and C are partners doing business under the firm name of A and B Company. They purchase a tract of land from P for the firm. The

deed of conveyance runs to "A and B Company, a partnership composed of A, B, and C." Is the conveyance valid? To whom does the title pass?

3. In the foregoing case, the deed of conveyance runs to "A and B Company, a partnership." Discuss the legal effect of the transaction.
4. A, B, and C are partners doing business under the firm name of the Southside Express Co. They purchase a tract of land for firm uses. The deed of conveyance runs to the "Southside Express Co., a partnership composed of A, B, and C." Discuss the legal effect of the deed.
5. The deed runs to the "Southside Express Co., a partnership." Discuss the legal effect of the deed.
6. Is there any good reason why a firm should not be permitted to acquire and hold real property in a fictitious name?

WOOD *v.* AMERICAN FIRE INSURANCE COMPANY

149 New York Reports 382 (1896)

Appeal from the judgment of the General Term of the Supreme Court affirming a judgment for the plaintiff.

O'Brien, J. The plaintiff recovered upon a policy of insurance, of which she was the assignee, issued by the defendant, upon a building used as a store, January 9, 1891, and was destroyed by fire March 31, 1891. The only defenses interposed by the answer, which were proved and found at the trial, were: (1) That Wood Brothers, a firm composed of six brothers, which owned the property and procured the insurance, had not, at the time, the sole and unconditional title or ownership of the property, and (2) that the property covered by the policy had been sold upon judgment and execution against the firm some days before the loss. The contract was made by means of what is known as the standard policy, which contained the condition that it "shall be void if the interest of the insured shall be other than *unconditional and sole ownership*, or if any change, other than by the death of an assured, takes place in the interest, title or possession of the subject of the insurance, whether by legal process or judgment, or by the voluntary act of the insured or otherwise."

With respect to the defense first referred to, it appeared that in the year 1885, one of the individuals composing the firm made a general assignment of his individual property for the benefit of his creditors, and also his interest in the firm. That in 1888 his assignee sold whatever interest in the firm property that passed to him by the assignment to a third party, and before the policy was issued had accounted and been discharged. The assignee had no accounting with

the firm in order to ascertain what interest the assignor had, if any, in the surplus, and no claim was ever made upon the firm for anything passing by the assignment. It appeared by the proofs and findings that the defendant's agents, who were, as may be fairly inferred, general agents, knew, at the time of issuing the policy, and before, all the facts and circumstances with respect to the individual assignment and the transfer of that interest as above stated.

The answer to the defense, based upon these facts, is twofold: (1) That since the title to the real estate held by a partnership is in the firm, and not in the individual members of it, the transfer of the interest of one of the members, before the insurance, had no effect upon the unconditional and sole ownership of the firm. (2) That an assignment by one partner of his share in the partnership stock simply transfers any interest he may have in any surplus remaining after payment of the firm debts and the settlement of the firm accounts. Whether the purchaser of such an interest takes anything whatever by the transfer cannot be known until all the partnership affairs have been settled and adjusted. *Menagh* v. *Whitwell*, 52 N.Y. 146, 11 Am. Rep. 683. The title to the real property, which was the subject of the insurance, was in the partnership firm, and was not affected by the assignment of one of the members. It still remained firm property, since the assignee had no interest in it as such, and whether the sale or transfer by the individual member was anything more than a mere form, or conveyed anything to the assignee, must depend upon the existence of a surplus after the partnership affairs are adjusted. It does not even appear in this case that there would then be any surplus to divide, though that circumstance cannot be regarded as material upon the question whether such a transfer by a member affects or changes the estate or interest which the firm has in the partnership realty.

The judgment must, therefore, be affirmed with costs.

QUESTIONS

1. Are partners tenants in common of firm property? Are they joint-tenants?
2. A and B have been engaged in business as partners. The firm owns real and personal property. What are the rights of the partners with respect to the firm property upon dissolution of the firm?
3. A demands that the property be divided in kind upon dissolution. Is he entitled to such a division?

4. A transfers his interest in the firm to C. What is the legal effect of this transfer? What rights does C get by the transfer?
5. S owns stock in a corporation which owns real and personal property. What is the nature of his rights with respect to the corporate property? Is he entitled to a division of the property in kind upon dissolution of the corporation?
6. S is the sole stockholder in a certain corporation. Is he owner of the property of the corporation? Can he sell such property? Can it be levied upon by creditors as property of S?

ANDREWS' HEIRS *v.* BROWN'S HEIRS

21 Alabama Reports 437 (1852)

DARGAN, C. J. When a partnership is dissolved by the death of one or more of the partners, the legal title to all the personal property and choses in action belonging to the firm becomes vested exclusively in the survivor; not, indeed, for his own peculiar benefit, but for the purpose of paying the debts, and then dividing the net balance among those entitled, giving to the representatives of the deceased partner the same interest he would have taken, had he been in life, and the firm had been dissolved, not by death, but by mutual consent. But, as respects real property, the case is different at law; for the legal title descends to the heir at law of the deceased partner, and a court of law, looking to the legal title alone, cannot regard or protect the mere equities of others. In a court of equity, however, real estate belonging to the firm is considered as personal property, to this extent, at least, that it is liable to pay the debts of the firm, and then to distribution between the partners, in the same manner as if it had been personal instead of real estate. These charges upon the real estate, being prior to the claims of the representatives of the deceased partner, override his wife's title to dower, as well as the title of his heir at law. The consequence is that the heir at law holds the legal title subservient to, or in trust for, the surviving partners, who is charged with the payment of the debts. These principles of law, in my opinion, are so well settled, that they are not longer the subject of controversy. Story on *Part.* 127, *et. seq.;* Collyer on *Partnership* (Perkins' ed.) 183 to 145; 5 Ala. 446; *Pierce* v. *Trigg,* Leigh 406; *Delmonico* v. *Guellaume et al.* 2 Sand. Ch. 366; *Dyer* v. *Clarke,* 5 Metc. 562; 7 Vesey, 425; 5 Hare, 369.

Inasmuch as the real estate is considered as personal, for the purpose of paying the debts of the firm, and the surviving partner

is charged with the duty of paying those debts, it must, of necessity, follow, that he has the right in equity to dispose of the real estate for this purpose; for it would never do to charge him with the duty of paying the debt, and at the same time to take from him the means of doing it. Therefore, although he cannot, by his deed, pass the legal title to the purchaser, which descended to the heir of the deceased partner, yet, as the heir holds the title in trust to pay the debts, and the survivor is charged with his duty, his deed will convey this equity to his purchaser, and through it, he may call on the heir for the legal title, and compel him to convey. See 2 Sand. Ch. 366; 5 Metc. 562, *supra.*

Applying these principles to the facts exhibited by the pleadings and proof in the case before us (but which we will not state in detail in this opinion), we can perceive no error in the decree; for the proof, we think, is abundant to show that, although the legal title to the lands was held by E. L. Andrews, alone, nevertheless they belonged to the firm as partnership property, and were so treated by all the members of the firm. They never did belong exclusively to E. L. Andrews; consequently, the claims of the creditors of the firm are superior to his widow's right of dower, as well as to the legal title of his heirs at law. The lands were purchased with the funds of E. L. and Z. Andrews, who were then partners, and stood upon their books as partnership property, and when the new firm was formed, composed of E. L. and Z. Andrews and Thomas G. Brown, these lands were carried into the new firm as part of its capital, and were, therefore, partnership property.

As to the stocks purchased with the funds of the new firm, it is very clear that they also are subject to the control and disposition of the surviving partner, Brown, notwithstanding they stand on the books of the bank and the insurance company in the name of E. L. Andrews alone. In reference to the money received by Messrs. Campbell and Chandler, growing out of the redemption of one of the lots by Mr. Gliddon, we think it should stand in the place of the lot itself, and, consequently, subject to the disposition made by Brown of the lot.

We are satisfied there is no error in the decree, and it must be affirmed.

I will observe, in conclusion, that we do not intend, by anything said in the foregoing opinion, to hold that a surviving partner is authorized to sell real estate for the simple purpose of making distribu-

tion among the partners themselves, and their representatives. That question is not raised in the case, and has not been considered; we only intend to decide this: the firm being insolvent, the surviving partner may dispose of the whole property to pay the debts, whether the property consists of real or personal estate.

The decree is affirmed.

QUESTIONS

1. Smith and Brown, partners, own a considerable amount of personal property. Smith dies. To whom does the title to the personal property pass? How is it administered after the death of Smith?
2. Smith purchases two horses in his own name for the firm. At his death to whom does title to the horses pass?
3. Smith and Brown jointly hold title to firm realty. Upon the death of Smith to whom does the title to the realty pass? How is it administered in the settlement of the affairs of the firm?
4. Brown holds title to firm realty in his individual name. Upon his death to whom does title to realty pass? How is it administered?
5. Is the doctrine of the principal case applicable generally in the settlement of the affairs of a partnership or only when the firm is insolvent?
6. S is the owner of ten shares of stock in a corporation which owns nothing but real property. Upon the death of S, to whom does the title to the stock pass?

BUTTON *v.* HOFFMAN

61 Wisconsin Reports 20 (1884)

ORTON, J. This is an action of replevin in which the title of the plaintiff to the property was put in issue by the answer.

In his instructions to the jury the learned judge of the circuit court said: "I think that the testimony is that the plaintiff had the title to the property." The evidence of the plaintiff's title was that the property belonged to a corporation known as "The Hayden & Smith Manufacturing Co.," and that he purchased and became the sole owner of all the capital stock of said corporation. As the plaintiff in his testimony expressed it, "I bought all the stock, I own all the stock now. I became the absolute owner of the mill. It belonged at that time to the company, and I am the company." There was no evidence of the condition of the corporation at the time. Is this sufficient evidence of the plaintiff's title? We think not. The learned counsel of the respondent in his brief says: "The property had formerly belonged to the Hayden & Smith Manufacturing Co.,

but the respondent had purchased and become the owner of all the stock of the company, and thus became its sole owner."

From the very nature of a private business corporation, or, indeed, of any corporation, the stockholders are not the private and joint owners of its property. The corporation is the real, though artificial person, substituted for the natural persons who procured its creation and have pecuniary interests in it, in which all its property is vested, and by which it is controlled, managed, and disposed of. It must purchase, hold, grant, sell, and convey the corporate property, and do business, sue and be sued, plead and be impleaded, for corporate purposes, by its corporate name. The corporation must do its business in a certain way, and by its regularly appointed officers and agents, whose acts are those of the corporation only as they are within the powers and purposes of the corporation. In an ordinary copartnership the members of it act as natural persons and as agents for each other, and with unlimited liability. But not so with a corporation; its members, as natural persons, are merged in the corporate identity. Ang. & A. on *Corp.*, sections 40, 46, 100, 591, 595. A share of the capital stock of a corporation is defined to be a right to partake, according to the amount subscribed, of the surplus profits obtained from the use and disposal of the capital stock of the company to those purposes for which the company is constituted. *Id.* section 557. The corporation is the trustee for the management of the property, and the stockholders are the mere *cestuis-que-trust*. *Gray* v. *Portland Bank*, 3 Mass. 365; *Eidman* v. *Bowman*, 4 Am. Corp. Cas. 350. The right of alienation or assignment of the property is in the corporation alone, and this right is not affected by making the stockholders individually liable for the corporate debts. Ang. & A. on *Corp.*, section 191; *Pope* v. *Brandon*, 2 Stewart (Ala.) 401; *Whitwell* v. *Warner*, 20 Vt. 444. The property of the corporation is the mere instrument whereby the stock is made to produce the profits, which are the dividends to be declared from time to time by corporate authority for the benefit of the stockholders, while the property itself, which produces them, continues to belong to the corporation. *Bradley* v. *Holdsworth*, 3 Mees. & W. 422; *Waltham Bank* v. *Waltham*, 10 Met. 334; *Tippets* v. *Walker*, 4 Mass. 595. The corporation holds its property only for the purposes for which it was permitted to acquire it, and even the corporation cannot divert it from such use, and a shareholder has no legal right to it, or the profits arising therefrom, until a lawful division is made by the directors or other proper officers

of the corporation, or by judicial determination. Ang. & A. on *Corp.*, sections 160, 190, 557; *Hyatt* v. *Allen*, 4 Am. Corp. Cas. 624. A conveyance of all the capital stock to a purchaser gives to such purchaser only an equitable interest in the property to carry on business under the act of incorporation and in the corporate name, and the corporation is still the legal owner of the same. *Wilde* v. *Jenkins*, 4 Paige, 481. A legal distribution of the property after a dissolution of the corporation and settlement of its affairs, is the inception of any title of a stockholder to it, although he be the sole stockholder. Ang. & A. on *Corp.*, section 779*a*.

These general principles sufficiently establish the doctrine that the owner of all the capital stock of a corporation does not therefore own its property, or any of it, and does not himself become the corporation, as a natural person, to own its property, and do its business in his own name. While the corporation exists he is a mere stockholder of it, and nothing else. The consequences of a violation of these principles would be that the stockholders would be the private and joint owners of the corporate property, and they could assume the powers of the corporation, and supersede its functions in its use and disposition for their own benefit without personal liability, and thus destroy the corporation, terminate its business, and defraud its creditors. The stockholders would be the owners of the property, and at the same time, it would belong to the corporation. One stockholder owning the whole capital stock could, of course, do what several stockholders could lawfully do. It is said in *Utica* v. *Churchill*, 33 N.Y. 161, "the interest of a stockholder is of a collateral nature, and is not the interest of an owner"; and in *Hyatt* v. *Allen*, *supra*, that a "shareholder in a corporation has no legal title to its property or profits until a division is made." In *Winona & St. Paul Railroad Co.* v. *St. P. & S. C. Railroad Co.*, 23 Minn. 359, it is held that the corporation is still the absolute owner, and vested with the legal title of the property, and the real party in interest, although another party has become the owner of the sole beneficial interest in its rights, property and immunities. In *Baldwin* v. *Canfield*, 26 Minn. 43, it was held that the sole owner of the stock did not own the land of the corporation so as to convey the same. In *Bartlett* v. *Brickett*, 14 Allen, 62, an action of replevin was brought by A., B., and C., as the "Trustees of the Ministerial Fund of the North Parish in Haverhill," which was the corporate name. In portions of the writ the plaintiffs were referred to as "the said trustees" and "the said plaintiffs." In the

bond, "A., B., and C., trustees as aforesaid," became bound, and the officer, in his return, certified that he had taken a bond "from the within-named A., B., C., plaintiffs." It was held that the action was not by the corporation as it should have been, and judgment was rendered for the defendant. It is said in *Van Allen* v. *Assessors*, 3 Wall. 584, "the corporation is the legal owner of all the property of the bank, both real and personal." In *Wilde* v. *Jenkins*, *supra*, where a copartnership bought all the property and effects, together with the franchises, of a corporation, and elected themselves trustees of the corporation, it was held that the corporation was not dissolved and that the legal title to the real and personal property was still in the corporation for their benefit. In *Mickles* v. *R. C. Bank*, 11 Paige, 118, it was held that, although a corporation was deemed to have surrendered its charter for non-user, it was not dissolved, and would not be until its dissolution was judicially declared, and that until then its property could be taken and sold by its judgment creditors. In *Bennett* v. *Am. Art Union*, 5 Sandf. Super. Ct. 614, it was held that, "as a general rule, the whole title, legal and equitable (to its property), is vested in the corporation itself," and that the individual members have no other or greater interest in it than is expressly given to them by the charter, and the prayer of the complainant, as a shareholder in the Art Union, for an injunction against a certain disposition of its property, was denied, because he had no interest in it. See also, *Goodwin* v. *Hardy*, 57 Me. 143.

It is true that none of the foregoing cases are precisely parallel with the present case in facts, but they are sufficiently analogous to be an authority upon the principle that the plaintiff, as the sole stockholder of the corporation, is not the legal owner of its property. He may have an equitable interest in it, but in this action he must show a legal title to the property in himself in order to recover, and he has shown that such title is in another person. *Timp* v. *Dockham*, 32 Wis. 146; *Sensenbrenner* v. *Mathews*, 48 Wis. 250. In analogy to the foregoing principle it was held in *Murphy* v. *Hanrahan*, 50 Wis. 485, that the sole heirs of an estate did not have such a legal title to a promissory note given to their father as would entitle them to sue the maker upon it, because the title to it was in the administrator, and they could obtain the title only by administration and distribution according to law. The heirs in that case certainly had as much equitable interest in that note as this plaintiff has in the property in controversy. The want of title to the property being fatal to the

plaintiff's recovery in the action between the present parties, other alleged errors will not be considered.

The judgment of the circuit court is reversed, and the cause remanded for a new trial.

QUESTIONS

1. A corporation, of which A, B, and C own all the stock, purchases a tract of land in its corporate name. Discuss the legal effect of the transaction.
2. A, B, and C as individuals execute a conveyance of the land to P. Discuss the legal effect of the transaction.
3. A became the sole stockholder in the corporation and for several years conducted the business as an individual. During this time he made a conveyance of the land in his own name to P. Later on the corporation was revived and made a conveyance of the same land to D who went into possession of it. P sues D for possession of the land. What decision?
4. D stole a horse from the corporation. A, one of the stockholders of the corporation, brings an action to recover the horse. What decision?

BRACKEN *v.* KENNEDY

4 Illinois Reports 558 (1842)

This was a bill in chancery filed in the La Salle Circuit Court, by the complainant against the defendants, for an accounting among partners. The bill states that in July, 1837, the complainant and defendants entered into partnership as canal contractors, and, as such partners, contracted with a canal company in Virginia, for the construction of section 120 of their canal, and that they completed said section 120 in August, 1838. That during the progress of the work, the complainant and Brady had the principal management of its construction, while most of the time Kennedy was absent. That at the same time Kennedy had an individual contract for the construction of sections 118 and 119 of the same canal, and Kennedy employed the complainant to superintend the completion of these sections. That this individual contract of Kennedy was unprofitable, and in the course of its progress, he became indebted to the copartnership, section 120, to about $8,000, for work and labor expended on sections 118 and 119. That the whole estimate for the company, section 120, was $32,320.90, including the work done on Kennedy's individual sections, and that the costs of the same were $23,783.82, leaving a balance of profits to be divided among the partners of $8,437.08. That the complainant has accounted with, and paid over

to Brady his third of said profits; and that there is now due from Kennedy to the complainant the sum of $3,959.03, arising from said partnership transactions. That Kennedy has drawn estimates on the works, and has drawn his last on his individual contracts. That no account has been taken or rendered between the said partners, and that Kennedy refuses to account. The bill prays that an account may be taken, etc.

To this bill a demurrer was filed, which was sustained, and the bill dismissed.

CATON, J. In matters of controversy or difficulty between partners, it is now most usual, and by far the most convenient, to resort to a court of equity for their final adjudication and settlement. The practice of this court is much better adapted to unravel, and definitely settle, such complicated questions as frequently arise among partners than a court of law; and it is now one of the most usual proceedings to be met with in courts of equity. It is not unusual that almost the entire proof of the merits of a case between partners is locked up in the bosoms of the parties themselves, or is contained in books and papers in the possession of one or the other party, and this court can afford the only key to the disclosure of the one, or the production of the other. Here, either party may compel the other to purge his conscience on oath and declare the truth; and the court will compel the production of all such papers and books as may be ncessary to elucidate the rights or liabilities of the parties. It is for this reason, also, that courts of equity have frequently exercised a concurrent jurisdiction with courts of law, in long and intricate accounts, running on both sides, between parties who are not partners, and have no interests in common.

It is true that courts of law still pretend to afford a remedy in case of difficulty between partners, by the action of account, but it is so incomplete and unsatisfactory, that it is now nearly obsolete; and the complaining partner almost universally lays his complaint before a court of chancery, where he finds a prompt and efficient remedy, from the superior facilities which it possesses of doing complete justice between the parties.

In a bill of this character, the existence of the partnership, the transaction of business by the firm, and no account among its members, are prominent features and where they all appear, I am not prepared to say that the bill ought not in all cases to be retained. In this case, the bill shows that there was a special and limited

partnership, the particular object of which is stated in it, as well as the nature and amount of the business transacted by the firm, and that no account has been had between the complainant and the defendant Kennedy, who refuses to account. Here, then, is such a case as requires the interposition of a court of chancery, to settle and adjust the rights and claims of the several partners. It is true that the bill states that the complainant and Brady have settled as between themselves, and that the complainant has succeeded to all of the rights and interests of Brady in the partnership business; but this does not make it the less necessary that an account should be had between the complainant and Kennedy, to settle their respective rights; and to accomplish this, it was necessary to make Brady a party to the bill. The bill also states that the partnership advanced to Kennedy, one of its members, in work, and labor, etc., to the amount of some $8,000, which is nearly the extent of the whole partnership profits, thus showing substantially that Kennedy had received nearly all of the profits of the work on section 120. In what way could this be recovered back by the other members of the firm, or in what way could he be compelled to account for these advances, unless by the mode here adopted? One member of a partnership cannot sue the firm at law for advances made by him to the joint concern; nor can the firm sue an individual partner for anything that he may have drawn out of the joint stock or proceeds, no matter how much more than his share it might have been; and the reason is, that one man cannot occupy the double position of plaintiff and defendant at the same time. The aid of this court is just as necessary to settle the account of these advances, as it is to settle the accounts arising out of the immediate transactions of the special business of the partnership.

The bill then being sufficient in substance, although not so particular as might be desirable, the demurrer should have been overruled. This disposes also of the second error.

Decree reversed.

QUESTIONS

1. A and B are partners trading under the firm name of the A Company. The firm has a cause of action against X. How will the action be brought? How would the action be brought if the company were a corporation?
2. The firm advanced $500 to B. The company brings an action at law against B for the money. What decision? Would your answer be the same if the company were a corporation?

3. A advances $500 to the firm. He brings an action at law to recover the amount. What decision? What decision in case the company were a corporation?
4. A and B dissolve their firm and A, with the consent of B, sells the firm property, pays all firm debts, and has left a balance of $7,500. A and B agree that A is entitled to $5,000 and that B is entitled to $2,500 of this amount. B brings an action at law to recover the $2,500. What decision?
5. A and B enter into a contract to form a partnership to engage in the real estate business. A is suing B at law for breach of his contract. What decision?
6. A and B entered into a contract to form a partnership and continue it for one year. Before the end of the year B withdrew from the business without A's consent. A is suing B at law for damages. What decision?

MASON *v.* ELDRED

6 Wallace's United States Reports 231 (1867)

Mason sued, in the circuit court for Wisconsin, Anson Eldred, Elisha Eldred, and one Balcom, trading as partners, upon a partnership note of theirs. Process was served on Anson Eldred alone, who alone appeared, and pleaded *non assumpsit*. On the trial, the note being put in evidence by the plaintiff, Eldred offered the record of a judgment in one of the state courts of Michigan, showing that Mason had already brought suit in that court on the same note against the partnership; where, though Elisha Eldred was alone served and alone appeared, judgment in form had passed against all the defendants for the full amount due upon the note.

The evidence being objected to by the plaintiff, because not admissible under the pleadings, and because it appeared on the face of the record that there was no judgment against either of the defendants named except Elisha Eldred, who alone, as appeared also, was served or appeared, and because it was insufficient to bar the plaintiff's action, the question whether it was evidence under the issue in bar of, and to defeat a recovery against, Anson Eldred, was certified to this court for decision as one on which the judges of the circuit court were opposed.

FIELD, J. If the note in suit was merged in the judgment, then the judgment is a bar to the action, and an exemplification of its record is admissible, for it has long been settled that under the plea of the general issue in assumpsit evidence may be received to show, not merely that the alleged cause of action never existed, but also

to show that it did not subsist at the commencement of the suit. *Young* v. *Black*, 7 Cranch, 565; *Young* v. *Rummel*, 2 Hill, 480. On the other hand, if the note is not thus merged, it still forms a subsisting cause of action, and the judgment is immaterial and irrelevant.

The question then for determination relates to the operation of the judgment upon the note in suit.

The plaintiff contends that a copartnership note is the several obligation of each copartner, as well as the joint obligation of all, and that a judgment recovered upon the note against one copartner is not a bar to a suit upon the same note against another copartner; and the latter position is insisted upon as the rule of the common law, independent of the joint debtor act of Michigan.

It is true that each partner is bound for the entire amount due on copartnership contracts, and that this obligation is so far several that if he is sued alone, and does not plead the non-joinder of his copartners, a recovery may be had against him for the whole amount due upon the contract, and a joint judgment against the copartners may be enforced against the property of each. But this is a different thing from the liability which arises from a joint and several contract. There the contract contains distinct engagements, that of each contractor individually, and that of all jointly, and different remedies may be pursued upon each. The contractors may be used separately on their several engagements or together on their joint undertaking. But in copartnerships there is no such several liability of the copartners. Copartnerships are formed for joint purposes. The members undertake joint enterprises, they assume joint risks, and they incur in all cases joint liabilities. In all copartnership transactions this common risk and liability exist. Therefore it is that in suits upon these transactions all the copartners must be brought in except when there is some ground of personal release from liability, as infancy or a discharge in bankruptcy, and if not brought in, the omission may be pleaded in abatement. The plea in abatement avers that the alleged promises, upon which the action is brought, were made jointly with another and not with the defendant alone, a plea which would be without meaning, if the copartnership contract was the several contract of each copartner.

The language of Lord Mansfield in giving the judgment of the king's bench in *Rice* v. *Shute*, 5 Burr. 2611, "that all contracts with partners are joint and several, and every partner is liable to pay the whole," must be read in connection with the facts of the case,

and when thus read does not warrant the conclusion that the court intended to hold a copartnership contract the several contract of each copartner, as well as the joint contract of all the copartners, in the sense in which these terms are understood by the plaintiff's counsel, but only that the obligation of each copartner was so far several that in a suit against him judgment would pass for the whole demand, if the nonjoinder of his copartners was not pleaded in abatement.

The plea itself, which, as the court decided, must be interposed in such cases, is inconsistent with the hypothesis of a several liability.

For the support of the second position, that a judgment against one copartner on a copartnership note does not constitute a bar to a suit upon the same note against another copartner, the plaintiff relies upon the case of *Sheehy* v. *Mandeville*, decided by this court, and reported in 6 Cranch, 254. In that case the plaintiff brought a suit upon a promissory note given by Jamesson for a copartnership debt of himself and Mandeville. A previous suit had been brought upon the same note against Jamesson alone, and judgment recovered. To the second suit against the two copartners the judgment in the first action was pleaded by the defendant, Mandeville, and the court held that it constituted no bar to the second action, and sustained a demurrer to the plea.

The decision in this case has never received the entire approbation of the profession, and its correctness has been doubted and its authority disregarded in numerous instances by the highest tribunals of different states. It was elaborately reviewed by the supreme court of New York in the case of *Robertson* v. *Smith*, 18 Johnson, 459, where its reasoning was declared unsatisfactory, and a judgment rendered in direct conflict with its adjudication.

In the supreme court of Massachusetts a ruling similar to that of *Robertson* v. *Smith* was made. *Ward* v. *Johnson*, 13 Mass. 148. In *Wann* v. *McNulty*, 2 Gilman, 359, the supreme court of Illinois commented upon the case of *Sheehy* v. *Mandeville*, and declined to follow it as authority. The court observed that notwithstanding the respect which it felt for the opinions of the Supreme Court of the United States, it was well satisfied that the rule adopted by the several state courts—referring to those of New York, Massachusetts, Maryland, and Indiana—was more consistent with the principles of law, and was supported by better reasons.

In *Smith* v. *Black*, 9 Sergt. & Rawle, 142, the supreme court of Pennsylvania held that a judgment recovered against one of two

partners was a bar to a subsequent suit against both, though the new defendant was a dormant partner at the time of the contract, and was not discovered until after the judgment. "No principle," said the court, "is better settled than that a judgment once rendered absorbs and merges the whole cause of action, and that neither the matter nor the parties can be severed, unless indeed where the cause of action is joint and several, which, certainly, actions against partners are not."

In its opinion the court referred to *Sheehy* v. *Mandeville*, and remarked that the decision in that case, however much entitled to respect from the character of the judges who composed the Supreme Court of the United States, was not of binding authority, and it was disregarded.

In *King* v. *Hoar*, 13 Meeson & Welsby, 495, the question whether a judgment recovered against one of two joint contractors was a bar to an action against the other, was presented to the court of exchequer and was elaborately considered. The principal authorities were reviewed, and the conclusion reached that by the judgment recovered the original demand had passed *in rem iudicatam*, and could not be made the subject of another action. In the course of the argument the case of *Sheehy* v. *Mandeville* was referred to as opposed to the conclusion reached, and the court observed that it had the greatest respect for any decision of Chief Justice Marshall, but that the reasoning attributed to him in the report of that case was not satisfactory. Mr. Justice Story, in *Trafton* v. *The United States*, 3 Story, 651, refers to this case in the exchequer, and to that of *Sheehy* v. *Mandeville*, and observes that in the first case the court of exchequer pronounced what seemed to him a very sound and satisfactory judgment, and as to the decision in the latter case, that he had for years entertained great doubts of its propriety.

The general doctrine maintained in England and the United States may be briefly stated. A judgment against one upon a joint contract of several persons, bars an action against the others, though the latter were dormant partners of the defendant in the original action, and this fact was unknown to the plaintiff when that action was commenced. When the contract is joint, and not joint and several, the entire cause of action is merged in the judgment. The joint liability of the parties not sued with those against whom the judgment is recovered, being extinguished, their entire liability is gone. They cannot be sued separately, for they have incurred no

several obligation, they cannot be sued jointly with the others, because judgment has already been recovered against the latter, who would otherwise be subjected to two suits for the same cause.

If, therefore, the common law rule were to govern the decision of this case, we should feel obliged notwithstanding *Sheehy* v. *Mandeville*, to hold that the promissory note was merged in the judgment of the court of Michigan, and that the judgment would be a bar to the present action. But by a statute of that state, Compiled Laws of 1857, Vol. 2, chap. 133, page 1219, the rule of the common law is changed with respect to judgments upon demands of joint debtors, when some only of the parties are served with process. The statute enacts that "in actions against two or more persons jointly indebted upon any joint obligation, contract, or liability if the process against all of the defendants shall have been duly served upon either of them, the defendant so served shall answer to the plaintiff, and in such case the judgment, if rendered in favor of the plaintiff, shall be against all the defendants in the same manner as if all had been served with process," and that, "such judgment shall be conclusive evidence of the liabilities of the defendant who was served with process in the suit, or who appeared therein; but against every other defendant it shall be evidence only of the extent of the plaintiff's demand, after the liability of such defendant shall have been established by other evidence."

Judgments in cases of this kind against the parties not served with process, or who do not appear therein, have no binding force upon them personally. The principle is as old as the law, and is of universal justice, that no one shall be personally bound until he has had his day in court, which means until citation is issued to him, and opportunity to be heard is afforded. *D'Arcy* v. *Ketchum*, 1 Howard, 165. Nor is the demand against the parties not sued merged in the judgment against the party brought into court. The statute declares what the effect of the judgment against him shall be with respect to them; it shall only be evidence of the extent of the plaintiff's demand after their liability is by other evidence established. It is entirely within the power of the state to limit the operation of the judgment thus recovered. The state can as well modify the consequences of a judgment in respect to its effect as a merger and extinguishment of the original demand, as it can modify the operation of the judgment in any other particular.

A similar statute exists in the state of New York, and the highest tribunals of New York and Michigan, in construing these statutes,

have held, notwithstanding the special proceedings which they authorize against the parties not served to bring them afterward before the court, if found within the state, that such parties may be sued upon the original demand.

In *Bonesteel* v. *Todd*, 9 Mich. 379, an action of covenant was brought against two parties to recover rent reserved upon a lease. One of them was alone served with process, and he appeared and pleaded the general issue, and on the trial, as in the case at bar, produced the record of a judgment recovered against himself and his co-defendant under the joint debtor act of New York, process in that state having been served upon co-defendant alone. The court below held the judgment to be a bar to the action. On error to the supreme court of the state this ruling was held to be erroneous. After referring to decisions in New York, the court said,

> No one has ever doubted the continuing liability of all parties. We cannot, therefore, regard the liability as extinguished. And, inasmuch as the new action must be based upon the original claim, while, as in the case of foreign judgments at common law, it may be of no great importance whether the action may be brought in form upon the judgment or on the previous debt, it is certainly more in harmony with our practice to resort to the form of action appropriate to the real demand in controversy. While we do not decide an action in form on the judgment to be inadmissible, we think the action on the contract the better remedy to be pursued.

In *Oakley* v. *Aspinwall*, 4 N.Y. 513, the court of appeals of New York had occasion to consider the effect of a judgment recovered under the joint debtor act of that state upon the original demand. Mr. Justice Bronson, speaking for the court, says:

> It is said that the original demand was merged in, and extinguished by the judgment, and consequently, that the plaintiff must sue upon the judgment, if he sues at all. That would undoubtedly be so if both the defendants had been before the court in the original action. But the joint debtor act creates an anomaly in the law. And for the purpose of giving effect to the statute, and at the same time preserving the rights of all parties, the plaintiff must be allowed to sue on the original demand. There is no difficulty in pursuing such a course; it can work no injury to anyone, and it will avoid the absurdity of allowing a party to sue on a pretended cause of action which is, in truth, no cause of action at all, and then to recover on proof of a different demand.

Following these authorities, and giving the judgment recovered in Michigan, the same effect and operation that it would have in

that state, we answer the question presented in the certificate, that the exemplification of the record of the judgment recovered against the defendant, Elisha Eldred, offered by the defendant, Anson Eldred, is not admissible in evidence in bar of, and to defeat a recovery against the latter.

QUESTIONS

1. What is the purpose of legislation like that under consideration in the principal case? Examine the laws of some state in which you are interested and see whether it has passed similar legislation.
2. What is meant by joint liability? several liability? joint and several liability? Which properly describes the liability of partners on partnership contracts? Which properly describes their liability for firm torts?
3. A, B, and C are partners. P sues A and B on a firm debt. A and B do not object to the non-joinder of C. Later P brings an action against C on the same debt. What decision?
4. A and B seasonably object to the non-joinder of C. What decision?
5. (*a*) P shows that he cannot serve process on C because he is out of the jurisdiction of the court. (*b*) P shows that C is dead. What decision in an action on a firm debt under each hypothesis?
6. How does the liability of a stockholder in a corporation differ from the liability of a partner?
7. How can a judgment creditor of a partnership proceed in getting satisfaction of his judgment? How does a judgment creditor of a corporation proceed in getting satisfaction of his judgment?

WILLMOTT *v.* LONDON ROAD CAR COMPANY

Law Reports 2 Chancery Division 525 (1910)

By a lease dated May 31, 1900, the plaintiff granted certain land and buildings to one Porter for a term of sixty-two and a half years, and Porter covenanted that he would not without the previous written consent of the plaintiff assign or underlet the possession of the premises or any part thereof. But such consent was not to be withheld in "respect of a respectable or responsible person." In February, 1901, the lease was with the plaintiff's consent assigned to the defendants, who entered into and took possession of the premises under the lease.

In 1908 the defendants sold their undertaking and property to the London General Omnibus Co., Limited, and in December, 1908, the defendants applied to the plaintiff for leave to assign the lease to that company. On April 9, 1909, the plaintiff refused to give his consent to the assignment. In the following July the defendants

without the plaintiff's consent let the London General Omnibus Co., Limited, into possession of the premises comprised in the lease. Thereupon the plaintiff commenced this action and claimed a declaration that he was entitled to re-enter and to recover possession of the demised premises as on a forfeiture of the said lease by reason of the defendants having without his written consent parted with the possession of the premises to the Omnibus Company, on the ground that that company was not a "person" within the meaning of the aforesaid covenant in the lease.

The defendants alleged in their defense that the London General Omnibus Co., Limited, was a "respectable and responsible person" within the meaning of those words in the lease, and counterclaimed for a declaration that they were entitled to assign the said premises to the Omnibus Company without further application to or receiving the consent of the plaintiff.

Neville, J., held that a corporation was not capable of being a "respectable and responsible person" within the meaning of the covenant, and that the plaintiff was entitled to recover possession.

The defendants appealed.

Fletcher Moulton, L. J. The question before us turns upon the construction of a provision in a lease, and of course in construing it we must take into consideration all the words that we find here. But, as the argument of the counsel has before indicated, the question naturally falls into two parts. We have first to consider whether the word "person" used in a provision of this type in a lease can include corporations or whether it is restricted to individuals. Then if we come to the conclusion that it can include corporations we have to consider whether the indications afforded by the two epithets which are applied to the word "person" in the lease in question are such as lead us to the conclusion that it bears a narrower sense here.

In my opinion there can be no question that the word "person" may include a corporation. The quotation from Blackstone's *Commentaries* is decisive on the point, and I have never known any doubt thrown upon it. But, as Lord Blackburn points out in *Pharmaceutical Society* v. *London and Provincial Supply Association* (5 A. C. 857), the fact that the word has an extended meaning in law does not bring with it as a matter of necessity that wherever that word is used we must attribute to it that extended meaning. He there points out that in ordinary parlance "person" would probably be used—certainly in many contexts—in a much narrower signification. He further

points out that in legal documents the probability would be that it was used in its more complete legal sense. In so saying the learned LORD does not in my opinion intend to draw any hard and fast line between two classes of documents and to lay down the principle that we must attribute a particular meaning to the word when used in one class of documents and must not attribute that meaning to it when used in the other. He intends, I think, to indicate that as we proceed from common parlance toward the most technical legal documents there will be a gradually increasing probability that the full legal sense is to be attached to the word. Now in the present case we are dealing with a lease, a document of a legal character, drawn up no doubt by persons in the legal profession, and I ask myself whether in this document the word "person" is to bear its full extended legal meaning or whether we are to attribute to it the narrower meaning which it bears so frequently in ordinary conversation. On this point we have a very valuable guide in the decision of CHITTY, J., in *In re Jeffcock's Trusts*, 51 L. J. (Ch.) 509. In that case some trustees under a will had power to let trust property to such person or persons as they might think fit, and they came to the court to know whether that authorized them to let the property to a limited company. This raised in the clearest way the question whether in a document of that type the proper interpretation (apart from indications to the contrary) of the word "person" was its extended sense or not, and CHITTY, J., decided that it must be deemed to be used in the extended sense. I cannot help thinking that it would have been a disastrous thing if it had been decided otherwise. I see no reason why trustees in such a case should be prevented from accepting eligible tenants merely because they are corporate bodies when they may be as capable of performing the covenants and paying the rent as any individual tenant the trustees might get. I may say also that I think that a gradual change in the organization of the business world has been going on for the last century, whereby more and more of the business of the country is transacted by corporations, and less and less by private individuals, and this would naturally bring and in fact has brought with it an increased tendency to use the word "person" as including all legal persons who can perform the duties of persons with regard to property. The possibility that a tenant would be a corporate body was very much smaller one hundred years ago than it is at the present time. Hence in any legal document dealing with the holding of property and the

performance of the obligations connected with it I should myself be inclined to hold that "person" was used in its extended sense unless there was something in the context or in the object of the provision which drove me to a different conclusion. In the present case there is nothing of the kind. A power to object on reasonable grounds to a person as an assignee of a lease is in my opinion only a provision for the protection of the lessor with regard to the proper user of the property and the performance of the covenants as to rent or otherwise, and I can see no reason why that should exclude any important branch of the wide class to which the word "person" is properly applied provided that members of that branch are capable of performing the obligations under the lease.

For these reasons I am of opinion that the first part of the argument of the plaintiff's counsel breaks down, and that if there were no adjectives qualifying the word the provision in the lease that the consent should not be withheld in respect of a person against whom there was no objection would certainly include corporations.

Now do the two epithets which qualify the word "person" indicate that the narrower sense is to be given to the word; in other words, are they so personal, so individual, that they preclude our including those artificial persons recognized by the law whom we call corporations? The word "responsible" is just as applicable to a company or any other incorporated body as it is to a person, and that has not been contested at the bar. The whole argument on this part of the case has been based on the word "respectable." In my opinion the word "respectable" points to the behavior of the person, primarily in carrying on his business, but probably also in the whole of his external relations, and I cannot see why it is not just as applicable in that sense to a corporation as it is to a natural person. It is perpetually used with regard to corporations. The instance that was given by FARWELL, L. J., in the course of the argument is probably as good as any. You might well say "No respectable insurance company adopts such and such a policy." Everybody would understand that to mean an insurance company which carried on its business in accordance with high principles and which had acquired a corresponding reputation. The object of this provision was that the property should only go into hands that would treat it so that the locality, if I might say so, would not lose reputation, and in which the performance of the covenants of the lease would be secure. I cannot see why the words "respectable" and "responsible" should not have

been inserted in order to exclude corporations that did not carry on business in a reputable manner or were not equal to the burdens of the covenants and therefore not responsible, and not with any intention to exclude corporations generally. For these reasons I come to the conclusion that the London General Omnibus Co. was a proper tenant as to whom consent to assign could not be refused, and I agree with the conclusion of the Master of the Rolls that the action must be dismissed and the appeal allowed.

QUESTIONS

1. What would have been the decision of the court in this case if the omnibus company had been a partnership?
2. X sells Blackacre to Y and stipulates in the conveyance that title to the land shall never vest in a "colored person." X sues the D Cemetery Company for possession of the land, alleging and proving that the D Company is a corporation and that all of its stockholders, directors, and officers are "colored persons." What decision? What would have been the decision in case the D Company had been a partnership?
3. A statute forbids "any person to sell cigarettes to minors." Is the D Company, a corporation, punishable under this statute?
4. Is a corporation a "person" within the meaning of the Fourteenth Amendment to the federal constitution which forbids a state to pass any law which will deprive any *person* of life, liberty, or property without due process of law?
5. The Constitution provides that under certain circumstances the federal courts shall have jurisdiction over controversies which arise between *citizens* of different states. Is a corporation a *citizen* within the meaning of this provision?
6. The Constitution provides that the *citizens* of each state shall be entitled to all the privileges and immunities of the *citizens* of the several states. Is a corporation a citizen within the meaning of this provision?

HALL'S SAFE COMPANY *v.* HERRING-HALL-MARVIN SAFE COMPANY

146 Federal Reporter 37 (1906)

SEVERENS, CIR. J. The gravamen of the complaint is that the defendants invade and injure the good will and reputation of the complainant's business by the adoption of the corporate name of the defendant, the "Hall's Safe Co.," and also by inducing the public, through advertisements, circulars, and other representations, to believe that their safes are the product of the complainant's business.

The defendants admit the acquisition by complainant of the properties, including the good will, of the Hall's Safe & Lock Co., but claim that the individual defendants were not by the sale of the latter company deprived of the right to organize a new company which shall include their family name, and that the name of "Hall's Safe Co.," is one which may lawfully be adopted.

Upon this contention it becomes important to determine what were and are the relations between the complainant and its predecessor in title and the several defendants. Undoubtedly the Herring-Hall-Marvin Co. acquired by its contract of purchase with the Hall's Safe & Lock Co. all its physical properties and the good will which it had acquired in its business, as well as the right to use such trade-names as had been customarily used to identify its products. It acquired also the right to require that the Hall's Safe & Lock Co. should go out of business, or, in substance, that it should not longer engage in business of the kind which it sold to the Herring-Hall-Marvin Co. But it is contended that the contract reaches beyond the corporation, the Hall's Safe & Lock Co., and binds the defendants who were stockholders and officers of the corporation, and prevents them and any corporation of which they may become stockholders and managers from doing what the Hall's Safe & Lock Co. could not do; and the principal reason for this contention is the fact that these individual defendants participated in the sale, and as stockholders, received its benefits.

We are of opinion that this proposition cannot be sustained. The contract which the Herring-Hall-Marvin Co. had was with the corporation only, and not with its stockholders or officers. The officers who conducted the business of the selling company were not parties to the contract. It is a familiar rule that an agent, who, having lawful authority, makes a contract with another for a known principal, does not bind himself, but his principal only (Story on *Agency*, sec. 261; Mechem on *Agency*, sec. 555; *Whitney* v. *Wyman*, 101 U.S. 392, 25 L. Ed. 1050), and the officers of a private corporation, in respect to their liability on contracts entered into by them in behalf of the corporation, stand upon the same footing as agents of private individuals. (21 Am. & Eng. Ency. of Law [2d ed.] 879; *Whitney* v. *Wyman*, *supra*.) If the purchaser desired to make the officers and agents of the selling corporation subject to the stipulations of the company in the contract of sale, it should have required their personal agreement to that effect.

The cases cited by counsel for the complainant to support their contention, that the court may look through the form of a corporate organization, and fasten upon the stockholders a liability for the acts of the corporation, do not support such a doctrine as applicable to contract relations. These are *State* v. *Standard Oil Co.*, 49 Ohio St. 137, 30 N.E. 279, 15 L.R.A. 145, 34 Am. St. Rep. 541; *McKinley* v. *Wheeler*, 130 U.S. 630, 9 Sup. Ct. 638, 32 L. Ed. 1048; and *Anthony* v. *American Glucose Co.*, 146 N.Y. 407, 41 N.E. 23. They were all cases where, for special purposes and in special circumstances, the court held that it was competent and proper to regard the rights and duties of stockholders in corporations. None of them impugns the general rule above stated that in matters of contract the officers and agents of a corporation are not bound personally by stipulations made by them in behalf of their principal. This rule is not affected by the circumstances that they are indirectly interested as stockholders in the contracts of their corporation. If it were so, it would break down all distinction between the corporate entity and its component parts.[1]

QUESTIONS

1. A, B, and C are owners of all the stock of the X Company, a corporation. The corporation, through its officers, sells its business to P and covenants that it will not re-engage in the same business in that locality for a period of five years. The covenant is signed by A and C as president and secretary, respectively, of the X Company. Before the expiration of the five years A buys ten shares of stock in the Y Company, a corporation competing with P. What are the rights of P, if any, against A? against the Y Company?
2. A, B, and C, partners in the hardware business, sell the business to P and covenant not to re-engage in the same business in that locality for a period of five years. Before the expiration of the five years, A, B, C, D, and E incorporate the Y Company and enter the hardware business in competition with P. What are the rights, if any, of P against A, B, and C? against the Y Company?
3. In the foregoing case, A, B, and C associate themselves with D and E and re-enter the hardware business as partners. What are the rights, if any, of P against A, B, and C? against the firm of which A, B, and C are members?

[1] The conclusion reached by the court on the points involved herein was affirmed in 208 U.S. 554.

UNITED STATES *v.* MILWAUKEE REFRIGERATOR TRANSIT COMPANY

142 Federal Reporter 247 (1905)

In Equity. On motion to strike out and on general demurrers to the bill by the Chicago, Rock Island & Pacific Railway Co. and others.

SANBORN, D. J. This is a bill in equity for an injunction to prevent the payment of alleged rebates on freight, brought under Elkins Act, February 19, 1903, c. 708, 32 Stat. 847 (U.S. Comp. St. Supp. 1905, p. 599). The defense outlined in argument of the demurrers is that it appears on the face of the bill that the alleged rebates were not paid back to the shipper (the brewing company), but to the Refrigerator Transit Co., and, in substance and effect, nothing more is shown than the payment to a soliciting agent (the Transit Company) of a commission of an eighth or tenth of the published tariff rates, thus showing, in real effect, acts neither unlawful, immoral, nor injurious. A motion is also made on behalf of the brewing company to strike out certain allegations averring prior and disconnected illegal acts on its part, said to be material in proof, to characterize the acts of its principal officers and managers in organizing the transit company, and rebut the theory that the moneys paid by the carriers to the transit company were paid as commissions for obtaining the business and not as prohibited rebates.

The bill, after stating that the Pabst Brewing Co., Milwaukee Refrigerator Transit Co., and Wisconsin Central Railway Co. are Wisconsin corporations, and the other defendants foreign corporations, that the attorney-general has directed these proceedings, and that the shipments originate in Milwaukee and continue in other states and countries, contain the following allegations, here given in brief outline (the figures refer to the numbered paragraphs of the bill): (11) The transit company was, on October 7, 1903, organized, *inter alia*, to operate refrigerator cars on defendants' and other lines. It owns and controls 540 such cars. It was conceived and is operated as defendant carriers well knew as a device to cover the receiving of rebates, concessions, and discriminations, to-wit: an eighth or tenth of the published rate; whereby the traffic is carried at less than published rates. Such rebates are paid and accepted under the pretense, claim, and guise of "commissions," and amount to large sums to complainants unknown.

(12) The transit company was incorporated by procurement of the attorneys of the brewing company, and at its instance and request, with a capital of $150,000, having five directors, and with power to acquire and operate refrigerator cars, and contract for the supply and operation of refrigerator transportation by land and water.

(13) The brewing company is a Wisconsin corporation operating a large brewery and selling and shipping beer into all the states and territories and to purchasers in foreign countries. It has a capital of $10,000,000 of 10,000 shares. Gustav Pabst and Fred Pabst are brothers, owning 2,000 shares, and with their mother and sisters over half of the stock. They vote and control a majority of the stock and have always directed and controlled the election of directors, and their action; they have been and are its president, vice-president, and general managers, and have always controlled all its sales, purchases, and shipments.

(14) Here occurs the passage above quoted as to rebates prior to the Elkins Act. Upon the passage of that act the brewing company was no longer able to directly secure rebates and cast about for some device to evade the statute, and the Pabsts, as such officers, and one Howe, as traffic manager, intending to contrive and operate a device for such evasion, caused the transit company to be formed. Of its 1,500 shares, 1,340 were issued to the two Pabsts, 35 shares to Fred Pabst's wife and the balance to dummy directors, to give color to the claim that its stock was not owned by the brewing company. After investigation by the interstate commerce commission in May, 1905, Gustav Pabst transferred his stock in the transit company to Fred Pabst, and had some person elected director in his place; but such acts were colorable merely, he still retaining a large pecuniary interest in the corporation, and participating in its control.

(15) Immediately on the creation of the transit company the Pabsts, as controlling officers of the brewing company, contracted with themselves as executive officers of the transit company, for a term not yet expired, to give the latter exclusive control of the shipment of all freight of the brewing company moving in interstate and foreign commerce, which it is still exercising. The contract was made to enable the transit company to route the shipment of such freight on the lines of such companies as will pay rebates, and withhold it from such as will not, and all rebates, concessions, and discriminations charged in the bill have been exacted by threats of such diversion. Many thousand tons of said freight have been hauled by defendant

carriers since the contract was made. On such shipments the brewing company pays to the carriers the full tariff rate, and the carriers pay the transit company for use of its refrigerator cars for mileage three-fourths of a cent to a cent per mile, and in addition an eighth or tenth of the sums paid them by the brewing company; and in every instance the property is transported by defendant carriers at an eighth or tenth less than the published tariff. Such rebates amount to many thousands of dollars, the exact sum unknown to complainants.

(16) All the defendant carriers well knew that the transit company was organized in the interest of the brewing company, and for the purpose of evading the law, and paid such rebates with like intent and purpose.

(18) The transit company claims and pretends that such repayments were made and accepted as compensation for its services in soliciting and procuring freight for carriage by defendants; but such claim or pretense is untrue. The transit company has entire control of all the shipping business of the brewery, comprising almost the entire business of the transit company, which it does not solicit; the only possible consideration moving from it to the carrier being its refraining to divert the business. All such repayments have always been known to all said parties to be a device of unlawful rebate, concession, and discrimination. But such payments constitute unlawful concession and discrimination, whether or not the transit company solicits the shipments, which, if not so solicited and procured, would be diverted from the carrier so paying.

Such are the charges of the bill challenged by the demurrers. Two questions are presented: Whether the payments are sufficiently shown to have been made "by any device whatever" not as commissions, but with intent to evade the law; and whether the two Wisconsin corporations are so united in interest, control, and management as to make them substantially the same.

That the transit company is controlled by the managing agents of the brewing company is entirely clear. But is it controlled by the shipper corporation? The solution of this question depends on whether the brewing corporation, in a case like this, is an association of individuals, rather than a legal entity apart from those who own and control it. No doubt the general rule that a corporation is a legal entity, and an institution, artificial, intangible, existing only by legal contemplation, and separate and apart from its constituents is firmly imbedded in the common law of this country. It has been so

laid down in hundreds of cases. In the Dartmouth College Case, Chief Justice Marshall adopted and expressed it almost in the exact language of Lord Coke, in Coke on *Littleton*, *27b;* and this definition has been universally approved, especially in cases involving the extent of the corporate powers.

A stockholder owning nearly all the stock cannot bind the corporation by a contract made in his individual capacity. *Donoghue* v. *I. & L. M. Railway Co.*, 87 Mich., 13, 49 N.W. 512; *Finley Shoe & Leather Co.* v. *Kurtz*, 34 Mich. 89; *England* v. *Dearborn*, 141 Mass. 590, 6 N.E. 837. It seems that an act of all the stockholders, as individuals, binds the corporation, as no one can object. *Bundy* v. *Iron Co.*, 38 Ohio St. 300 (mortgage by all but one stockholder, to the remaining one, of corporate property, executed in the individual names of the stockholders, held valid). A corporation, from one point of view, may be considered an entity, without regard to its shareholders, yet the fact remains self-evident that it is not in reality a person or thing distinct from its consistent parts. The word corporation is but a collective name for the members who compose the association.

If any general rule can be laid down, in the present state of authority, it is that a corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but, when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons. This much may be expressed without approving the theory that the legal entity is a fiction, or a mere mental creation; or that the idea of invisibility or intangibility is a sophism. A corporation, as expressive of legal rights and powers, is no more fictitious or intangible than a man's right to his own home or his own liberty.

Applying the rule here laid down to the circumstances shown to surround the brewing company and transit company, can it be doubted that there really is, in substance and effect, an identity of interest, or that the brewing company, considered as an association of individuals, really owns and fully controls the transit company? or that the payment of the eighth or tenth of the rate is in reality, and in some form, a payment to, or for, the benefit of the shipper? I think sufficient is alleged to show this. Moreover, it clearly appears that the shipper practically controls the transit company, and I think this shows a sufficient identity of interest among the shareholders of

both in these repayments to make them rebates, if paid and received with unlawful intent. It is said that the procurement of the shipments through the contract is the mere soliciting of them for the carriers, for which they are lawfully authorized to pay a part of the rate, in order to get the business; and the transit company, owning a large number of refrigerator cars, and wishing to keep them employed, simply gives the freight to those competing shippers who will make the best terms, the business being of great volume, and the sums paid for freights large. But this theory of innocence is exploded by the fact, as alleged (whatever the actual proof may show) that the transit company is a mere separate name for the brewing company, being in fact the same collection of persons and interests. Assuming the truth of the averments, the device adopted is "neither new, nor deserving of new success." As the patent lawyers say of an aggregation, there is no new mode of operation, new use, or new result—simply the use of old things in a different situation.

There is no doubt some tendency in these days to accept general and vague charges of wrongdoing on the part of the corporations at a premium. Much has happened to arouse public feeling on this sensitive subject. For many years transportation development was encouraged in every possible way. The municipal aid craze was an early form of such stimulation. Praise for those who were seeking command of the trade of the world was unstinted and without dissent, and criticism forgotten. But now that we are beginning to feel the tyranny of arbitrary and overwhelming industrial and commercial power, the tendency is to go to the other extreme, and it becomes easy to excite prejudice leading to injustice. The courts will no doubt be somewhat influenced by such tendency; but so far as possible it is for them to keep fundamental rules steadily in view, and with discrimination and careful reflection see to it that injustice is prevented. Joseph Cooke once facetiously said that he had never traveled in Pennsylvania, but had often visited the domains of the Pennsylvania Railroad Co. These and other like domains are now subject to widespread attack; but it will not be forgotten that they are our domains, and, if they are being despoiled, the spoliation is the work of our trustees, who must indeed be brought to book, but the trust property at the same time preserved.

The demurrers are overruled, and the motion to strike out denied.

QUESTIONS

1. The stockholders of ten competing corporations met and informally agreed to transfer their stock to common trustees and to grant to them full voting power of the stock for the purpose of securing concentrated control of the various competing corporations. This is a proceeding against one of the corporations to forfeit its charter on the ground that it has entered into a combination in restraint of trade. What decision?
2. D sold his business to P and contracted that he would not re-enter the same business in competition with P for a period of five years. D, with A and B, immediately promoted a corporation, subscribed for 90 per cent of its stock, and began business in competition with P. What are the rights of P, if any, against D? against the corporation which D organized?
3. To what extent is a corporation personified? What is the justification for the personification of a corporation? Under what circumstances will the court disregard the corporate fiction?
4. To what extent is a partnership personified by law?
5. What are the advantages and disadvantages of conducting a business as an individual enterpriser? What are the advantages and disadvantages of conducting a business through agents?
6. What are the advantages and disadvantages of a partnership as an organization device for carrying on business? of a corporation? of a limited partnership? of a common law trust company? of a combination of corporations?

CHAPTER III

FORMATION OF THE BUSINESS UNIT

1. Promotion of the Unit

McARTHUR *v.* TIMES PRINTING COMPANY

48 Minnesota Reports 319 (1892)

Action for breach of an alleged contract of employment. The plaintiff had a verdict for $450. The defendant moved for a new trial. The motion was denied and the defendant appealed.

MITCHELL, J. The complaint alleges that about October 1, 1889, the defendant contracted with plaintiff for his services as advertising solicitor for one year; that in April, 1890, it discharged him, in violation of the contract. The action is to recover damages for the breach of the contract. The answer sets up two defenses: (1) That plaintiff's employment was not for any stated time, but only from week to week; (2) that he was discharged for good cause. Upon the trial there was evidence reasonably tending to prove that in September, 1889, one C. A. Nimocks and others were engaged as promoters in procuring the organization of the defendant company to publish a newspaper; that, about September 12, Nimocks, as such promoter, made a contract with plaintiff, in behalf of the contemplated company, for his services as advertising solicitor for the period of one year from and after October 1, the date at which it was expected that the company would be organized; that the corporation was not, in fact, organized until October 16, but that the publication of the paper was commenced by the promoters October 1, at which date plaintiff, in pursuance of his arrangement with Nimocks, entered upon the discharge of his duties as advertising solicitor for the paper; that after the organization of the company he continued in its employment in the same capacity until discharged, the following April; that defendant's board of directors never took any formal action with reference to the contract made in its behalf by Nimocks, but all the stockholders, directors, and officers of the corporation knew of this contract at the time of its organization, or were informed of it soon afterward, and none of them objected to or repudiated it, but, on the

contrary, retained plaintiff in the employment of the company without any other or new contract as to his services.

There is a line of cases which hold that where a contract is made in behalf of, and for the benefit of, a projected corporation, the corporation, after its organization, cannot become a party to the contract either by adoption or ratification of it. *Abbot* v. *Hapgood*, 150 Mass. 248 (22 N.E. Rep. 907), Beach, *Corp.* section 198. This, however, seems to be more a question of name than of substance; that is, whether the liability of the corporation, in such cases, is to be placed on the grounds of its adoption of the contract of its promoters, or upon some other ground, such as equitable estoppel. This court, in accordance with what we deem sound reason, as well as the weight of authority, has held that, while a corporation is not bound by engagements made on its behalf by promoters before its organization, it may, after its organization, make such engagements its own contracts. And this it may do precisely as it might make similar original contracts; formal action of its board of directors being necessary only where it would be necessary in the case of a similar original contract. That it is not requisite that such adoption or acceptance be expressed, but it may be inferred from acts or acquiescence on part of the corporation, or its authorized agents, as any similar original contract might be shown. *Battelle* v. *Northwestern Cement & Concrete Pavement Co.*, 37 Minn. 89. (33 N.W. Rep. 327.) See also, Mor., *Corp.* sec. 548. The right of the corporate agents to adopt an agreement originally made by promoters depends upon the purposes of the corporation and the nature of the agreement. Of course the agreement must be one which the corporation itself could make, and one which the usual agents of the company have express or implied authority to make. That the contract in this case was of that kind is very clear; and the acts and acquiescence of the corporate officers, after the organization of the company, fully justified the jury in finding that it had adopted it as its own.

The defendant, however, claims that the contract was void under the statute of frauds, because, "by its terms, not to be performed within one year from the making thereof," which counsel assumes to be September 12—the date of the agreement between plaintiff and the promoter. This proceeds upon the erroneous theory that the act of the corporation, in such cases, is a ratification, which relates back to the date of the contract with the promoter, under the familiar maxim that "a subsequent ratification has a retroactive effect, and is

equivalent to a prior command." But the liability of the corporation, under such circumstances, does not rest upon any principle of the law of agency, but upon the immediate and voluntary act of the company. Although the acts of a corporation with reference to the contracts made by promoters in its behalf before its organization are frequently loosely termed "ratification," yet a "ratification" properly so called, implies an existing person, on whose behalf the contract might have been made at the time. There cannot, in law, be a ratification of a contract which could not have been made binding on the ratifier at the time it was made, because the ratifier was not then in existence. In the Empress Engineering Co., 16 Ch. Div. 128; *Melhado* v. *Porto Alegre, N.H. & B. Railway Co.*, L.R. 9 C.P. 505; *Kelner* v. *Baxter*, L.R. 2 C.P. 185. What is called "adoption" in such cases, is in legal effect, the making of a contract of the date of the adoption, and not as of some former date. The contract in this case was, therefore, not within the statute of frauds. The trial court fairly submitted to the jury all the issues of fact in this case, accompanied by instructions as to the law which were exactly in the line of the views we have expressed; and the evidence justified the verdict.

The point is made that plaintiff should have alleged that the contract was made with Nimocks, and subsequently adopted by the defendant. If we are correct in what we said as to the legal effect of the adoption by the corporation of a contract made by a promoter in its behalf before its organization the plaintiff properly pleaded the contract as having been made with the defendant. But we do not find that the evidence was objected to on the ground of variance between it and the complaint. The assignments of error are very numerous, but what has already been said covers all that are entitled to any special notice.

Order affirmed.

QUESTIONS

1. What is a promoter? What economic functions does he perform? What legal functions does he perform?
2. What is meant by a promotion agreement? Between what parties is it made? What subject-matter does it usually cover?
3. What is meant by the prospectus of a corporation? What subject-matter does it cover? What functions does it perform?
4. The contract in the principal case was made for the corporation, but the court said that it was incapable of being ratified by the corporation. Why?

5. The court said that the corporation adopted the contract of the promoter with the plaintiff. What is meant by adoption in this connection? How is such an adoption proved?
6. Is a promoter bound personally by contracts which are made in the promotion and organization of a corporation? Can he enforce such contracts against the parties with whom they are made?
7. P transfers a patent to X who is promoting a corporation with the understanding that the patent is to be assigned to the corporation when it comes into existence. The corporation uses the patent for a year but refuses to pay P for it. P brings an action against the corporation for the reasonable value of the patent. What decision?
8. P expends considerable time and money in bringing the D Company into existence as a corporation. He brings an action against the corporation for the reasonable value of his services. What decision?
9. Would your answer be the same to the foregoing case if the directors of the corporation, after it came into existence, voted to compensate P for promotion services?
10. In some states statutes provide that the corporation shall upon being organized be liable in a reasonable amount for promotion services. Is there any justification for such a statute?

DENSMORE OIL COMPANY *v.* DENSMORE

64 Pennsylvania State Reports 43 (1870)

SHARSWOOD, J. There are two principles applicable to all partnerships or associations for a common purpose of trade or business, which appear to be well settled on reason and authority.

The first is, that any man or number of men, who are the owners of any kind of property, real or personal, may form a partnership or association with others, and sell that property to the association at any price which may be agreed upon between them, no matter what it may have originally cost, provided there be no fraudulent misrepresentation made by the vendors to their associates. They are not bound to disclose the profit which they may realize by the transaction. They were in no sense agents or trustees in the original purchase and it follows, that there is no confidential relation between the parties, which affects them with any trusts. It is like any other case of vendor and vendee. They deal at arms' length. Their partners are in no better position than strangers. They must exercise their own judgment as to the value of what they buy. As it is succinctly and well stated in *Foss* v. *Harbottle*, 2 Hare, 489, "A party may have a clear right to say, I begin the transaction at this time.

I have purchased land, no matter how or from whom, or at what price. I am willing to sell it at a certain price for a given purpose." This principle was recognized and applied by this court in the recent case of *McElhenny's Administrators* v. *The Hubert Oil Co.*, decided May 11, 1869 (11 P. F. Smith, 188). "It nowhere appears," said the present CHIEF JUSTICE, "that McElhenny, the purchaser from Hubert, the original owner, did it as the agent of Messrs. Baird, Boyd & Co., and others, though he bought it to sell again, no doubt; he had a perfect right, therefore, to deal with them at arms' length, as it seems he did." And again: "If the property was not purchased by McElhenny for the use, and as agent for the company, but for his own use, he might sell it at a profit, most assuredly. No subsequent purchasers from his vendees would have any right to call upon him to account for the profits made on his sale." In that case, McElhenny, being the owner of property which had cost him only $4,000, sold it to Baird, Boyd & Co., and others, who associated with him to form an oil company for $12,000, and it was decided that the company could not call him in equity, to account for the profit he had made.

The second principle is, that where persons form such an association or begin or start the project of one, from that time they do stand in a confidential relation to each other and to all others who may subsequently become members or subscribers, and it is not competent for any of them to purchase property for the purposes of such a company, and then sell it at an advance without a full disclosure of the facts. They must account to the company for the profit, because it legitimately is theirs. It is a familiar principle of the law of partnership, that one partner cannot buy and sell to the partnership at a profit; nor if a partnership is in contemplation merely, can he purchase with a view to a future sale, without accounting for the profit. Within the scope of the partnership business, each associate is the general agent of the others, and he cannot divest himself of that character without their knowledge and consent. This is the principle of *Hichens* v. *Congrove*, 4 Russ. 562, *Fawcett* v. *Whitehouse*, 1 Russ. & M. 132, and the other cases which have been relied on by the appellants. It was recognized in *McElhenny's Administrators* v. *The Hubert Oil Co.*, just cited, and also in *Simons* v. *The Vulcan Oil Co.*, decided by this court, May 11, 1869 (11 P. F. Smith, 202). Both of these cases were complicated with evidence of actual misrepresentations as to the original cost of the property to the vendors. In the

opinion of the court in the last case, delivered by THOMPSON C. J., it is said:

> If the defendants in fact acted as the agents of the company in acquiring the property, they could not charge a profit as against their principal. Nor was their position any better if they assumed so to act without precedent authority, if their doings were accepted as the acts of agents by the association or company. If, in order to get up a company, they represented themselves as having acted for the association to be formed, and proposed to sell at the same prices they paid, and their purchases were taken on these representations, and stockholders invested in a reliance upon them, it would be a fraud on the company, and all those interested, to allow them to retain the large profits paid them by the company in ignorance of the true sums actually advanced.

The defendants in that case were subscribers with others, to the stock of a projected oil company, and after the plan had been formed, secured to themselves by contract, the refusal of the property which they afterward sold to the company at a greatly advanced price.

The question now presented is, under which of these two principles is the present case to be classified. That will depend upon the facts, which, though the testimony is somewhat voluminous, may be briefly stated. Densmore, Roudebush, and Canfield, three of the defendants, were the owners of certain lands, leases, and rights, in Venango County, in the oil region. They had acquired them, so far as appears, with no idea of disposing of them, or of forming a company, but had spent over $100,000 in improving and developing them while they were owners. In March, 1864, they came to Philadelphia to ascertain whether they could be sold to advantage. They called upon Mr. Lawrence, another of the defendants, and consulted him as to the best mode of affecting this object. They stated that they were willing to accept $202,000, provided the sum could be procured clear of all expenses. That seemed impossible, unless by naming a price so much beyond that sum as would cover all such probable expenses and contingencies. The only mode by which so large an amount could be realized, was by the organization of a stock company, and to do that effectively persons must be employed as agents to sell or solicit subscription to the stock; and they must be gentlemen of character and influence, well acquainted with the subject, who could bring the land to the notice of those desirous of engaging in such an enterprise. The amount to be raised was large, the result uncertain.

Several agents must be employed, and their compensation must be at a liberal rate. It was arranged that the price should be fixed at $250,000; that the stock should be 50,000 shares at $10 a share, and $5 to be paid in cash. Mr. Densmore and his associates agreed to take $122,500 in money, and the balance in stock and that from this stock they would compensate the agents for their services. Mr. Densmore, who was examined as a witness on behalf of the appellants, testified: "The $122,500 was the proceeds of the sale of 24,500 shares. That added to the 16,000 shares we were to get, amounted to 40,500 shares. The arrangement, as I understood it, was that Messrs. Lawrence, Hugel, Watson, and perhaps parties unknown to me, were to receive the balance of the stock for their services in forming the company, and disposing of the stock." The gentlemen named were accordingly engaged for this purpose. They proceeded and did sell the 24,500 shares in order to make the cash payment. There was no subscription paper. Mr. Lawrence and his associates did not subscribe for any stock. They did not appear, and were not held out as subscribers to those who made purchases from them. It is true, that after the company was organized, the stock which they were to receive from Densmore, Roudebush, and Canfield, as a compensation for their services, was issued to them directly, not to the vendors, and by them transferred. But this was done by a special order, as is satisfactorily explained in the testimony of E .B. Schneider: "I heard Mr. Densmore request Mr. Lawrence to have the Densmore stock, which he [Mr. Lawrence], Watson, Hugel, and Whitenery, were entitled to, issued direct to themselves, as he might not be here when the certificates would be ready." It has not been, and cannot be, controverted, that the stock which they received was part of that which under the original terms of sale, Densmore, Roudebush, and Canfield, were to have in payment of the purchase money.

Now it can hardly be questioned, and indeed, apart from their alleged liability as confederates with the other defendants it has not been questioned, that Densmore, Roudebush, and Canfield fall within the first principle hereinbefore stated. They had, for a considerable time, been the owners of the property, had acquired it with no reference to the formation of this or any other company, and had improved and developed it by a very large outlay of their own capital. They had a clear and undoubted right to put their own price upon it in the formation of a company, in which they were to be partners or associates. They did put upon it the price of $250,000 which it is admitted

at the rates at which such property was then selling in the market, was a fair and reasonable, nay, even a low price. "From my knowledge of mining properties in the oil region at the time," said N. B. Browne, Esq., in his testimony, "and especially of the leasehold and other interests conveyed to this company, I regarded their interests at the price named, $250,000, as cheaper than any that were offered in this market. Their actual productive value was very great; the leases were on what was regarded as the best territory in Oil Creek." Had Messrs. Densmore, Roudebush, and Canfield employed no agents, but sold all the stock themselves, the transaction as to them could not have been impeached. They certainly stood in no confidential relation to the subscribers or purchasers of the stock in the future, when they acquired the property. This is necessary, as we have seen. A company or partnership must have been then forming or formed, or at least the project must have been started, in order that any confidential relation should arise. How then is their position varied by the fact that they employed agents and agreed to compensate these agents by a transfer of a certain part of the stock they were to receive? It is not easy to see. The whole $250,000, money and stock, when received, was their own absolute property; they could give or transfer it to whomsoever they pleased. If, as we have seen, they stood in no confidential relation to the company, no trust could attach to the price or any part of it in their hands. We may dismiss, therefore, the case of Messrs. Densmore, Roudebush, and Canfield as clearly within the first principle to which we have before adverted.

But what confidential relation did the other defendants sustain to the purchasers of the stock or to the company? It is a clear and unquestionable fact in the cause that they did not subscribe for a single share. Their contract was with Densmore, Roudebush, and Canfield to receive from them a part of their stock. Without an order from them, Mr. Lawrence and the others could not have compelled the company to issue any of it to them. If Densmore, Roudebush, and Canfield had received all the certificates to which they were entitled, and then refused to transfer, the only remedy of Messrs. Lawrence and others would have against them to recover damages for violation of their contract. It is clearly proved that the paper among the exhibits headed "Subscription List to the Densmore Oil Company" was made out by Mr. Lawrence, after the organization as a list of those to whom certificates of stock were to be issued. The

names of Lawrence, Whitney, Watson, and Hugel appeared on the list, but clearly only as appointees or assignees of Densmore, Roudebush, and Canfield. The same appointment or order might have been given by them to mere strangers.

It is strenuously contended, however, that if these defendants did not stand in a confidential relation to the purchasers of stock, then there was nobody who stood in that relation. But is there anything extraordinary in that? Nine-tenths of the transactions and contracts of life are at arms' length. If a man buys stock in the market of a broker, there is nobody who stands in that relation. He acts on his own judgment. He is bound to pay the broker the price agreed, and the broker is bound when paid to deliver him the stock. This was the only relation in which Lawrence, Whitney, Hugel, and Watson stood to those who bought stock from them, and who, according to all the testimony in the cause, so understood it. They supposed, as they state, that these gentlemen were to receive compensation for their services. What it was to be they did not inquire, because it was none of their business.

A strong effort, however, has been made, to show that these defendants, Lawrence, Whitney, Watson, and Hugel were purchasers from Densmore, Roudebush, and Canfield of an interest in the property, and sold it at an advance. But of this there is not a spark of evidence. It can hardly be pretended that Densmore, Roudebush, and Canfield could have held them liable on a contract to purchase any interest in the land or that the agents could in any event have sued them for not conveying to them such interest. If this was so, how can it be contended that they were vendors of any part of the property to the company?

Densmore, Roudebush, and Canfield were first and last the only vendors. They executed the deed, and very properly receipted for the whole of the purchase money, for they were entitled to the whole of it. Nor is the fact that Lawrence, Whitney, Watson, and Hugel joined with Densmore, Roudebush, and Canfield, as original corporators, and signed the articles for the organization of the company, under the act of July 18, 1863 (Pamph. L. 1864, p. 1102), a fact of any significance. That act does not require that the corporators should be subscribers to stock. They need have no interest whatever in the company to be formed. They are mere instruments of the law for the purposes of preliminary organization. The moment that is accomplished, the amount required as capital paid in, the necessary

certificate signed, and the charter granted, they are *functi officio*. The corporation is thenceforth composed of the stockholders.

It is supposed that the cases of *McElhenny's Administrators* v. *The Hubert Oil Co.* and *Simons* v. *The Vulcan Oil Co.*, before referred to, ought to rule this cause. But an examination of the opinions in those cases will show that the facts upon which they were decided were entirely different from those which appear on this record. The defendants there were subscribers to the stock; they became purchasers of the property after the project of a company was started and, moreover, falsely represented that they had purchased it at the same price at which they sold.

These facts, which were the grounds upon which those determinations were based, are not, as we have seen, the facts of this case. It is not pretended that any false representation was made by any of these defendants in the sale of the stock. Some other points have been raised, which are, however, sufficiently disposed of in the opinion below.

Decree affirmed and appeal dismissed at the cost of the appellants.

QUESTIONS

1. D, owner of land for which he originally paid $5,000, promoted a corporation and sold the land to it for $15,000. This is an action by the corporation against D for $10,000 alleged to be secret profits which D made at the expense of the corporation. What decision?
2. D bought stock in the corporation and was elected to the board of directors. He thereupon offered the land to the corporation for $15,000. The corporation accepted the offer. D was present at the meeting of the directors and his vote was necessary to the corporate action in question. What decision in an action by the corporation against D for secret profits?
3. D purchased a tract of land for $5,000, intending to form a corporation to which the land should be sold. He later sold the land to the corporation for $15,000. What are the rights, if any, of the corporation against D?
4. D buys land for $5,000 intending to form a partnership to which the land should be sold. The firm takes the land over at a valuation of $15,000. What are the rights, if any, of the firm against D?
5. A, B, and C organize a syndicate, buy mineral properties, reasonably worth $1,000,000, organize a corporation with a capitalization of $3,750,000, divided into 150,000 shares of stock with a par value of $25 a share. When the corporation came into existence A, B, and C

became its directors. The directors immediately voted to buy the properties from the syndicate and to issue 130,000 shares of the corporate stock in payment therefor. They later voted to sell the remaining 20,000 shares to the public at par value. This is an action by the corporation, prosecuted in the name of the holders of the 20,000 shares of stock last issued, for alleged secret profits made by A, B, and C. What decision?

6. A, B, and three other persons owned coal land worth about $25,000. They organized a corporation with a capitalization of $50,000 divided into 500 shares at $100 a share. The corporation purchased the land from A, B, and the others at an agreed valuation of $40,000. The corporation issued to each of the associates 80 shares of stock in the corporation and left unissued 100 shares. Two years later it was found that more money was needed to carry on the business successfully. The corporation thereupon offered the remaining 100 shares of stock to the public at par value. What are the rights, if any, of the purchasers of this stock?

2. Organization of the Unit

HAUG *v.* HAUG

193 Illinois Reports 645 (1901)

The Appellate Court, in their opinion deciding this case, make the following statement of facts, to-wit:

Appellee filed a bill in chancery in the circuit court of Jasper County against appellant to require him to account to her as administratrix of the estate of Martin Haug, deceased, for a claimed copartnership interest of deceased in a mercantile business, carried on and conducted for several years by appellant and deceased as copartners at Hunt City, under the name of "A. Haug & Son," and which partnership terminated by the death of Martin Haug, February 18, 1899.

The bill prays for an accounting of the partnership affairs, also for an injunction and receiver.

The court rendered a decree, finding that the deceased and appellant were copartners, and that appellant should account to appellee for one-fourth of the partnership assets after payment of the debts of the firm, and that appellant pay the costs.

An appeal was taken from the decree, so rendered by the circuit court, to the Appellate Court, and the Appellate Court has affirmed the decree. The present appeal is prosecuted from such judgment of affirmance.

MAGRUDER, J. The appellant, Andrew Haug, Sr., was the father of Martin Haug, deceased, whose widow and administratrix filed this bill for an accounting. It is undisputed that the appellant and his son, Martin, did business together under the firm name of "A. Haug & Son" for a number of years. They dealt, as such firm, in hardware, furniture, and agricultural implements.

There is no evidence in the record of any express contract of partnership, or written agreement of partnership, between the parties. It is well settled, however, that written articles of agreement are not necessary to constitute a partnership, but that a partnership may exist under a verbal agreement. (*Bopp* v. *Fox*, 63 Ill. 540.) The existence of a partnership may be implied from circumstances. (*Kelleher* v. *Tisdale*, 23 Ill. 405.) A partnership may arise out of an arrangement for a joint business, wherein the word "partnership" may not have been used. "If there is such a joinder of interests and action as the law will consider as equivalent, and regards as in effect, constituting a partnership, it will give to the persons so engaged all the rights, and lay upon them all the responsibilities and to give third persons all the remedies which belong to a partnership." (*Morse* v. *Richmond*, 6 Ill. App. 166.)

It is also well settled that when, by agreement, persons have a joint interest of the same nature in a particular adventure, they are partners *inter se*, although some contribute money and others labor. Such a partnership may well exist, although the whole capital is in the first instance advanced by one party, and the other contributes only his time and skill and ability in the selection and purchase of the commodities. (*Robbins* v. *Laswell*, 27 Ill. 365.)

The most significant circumstance, bearing upon the question whether or not there was a partnership between the appellant and his deceased son, is the fact that they did business together under the firm name of "A. Haug & Son." The proof shows conclusively that the son here referred to was the deceased son, Martin, and that the two members of the firm of A. Haug & Son were the appellant and his son, Martin. The fact that the parties do business together under a firm name is a circumstance which, although not conclusive by itself, may be considered by a court or jury, in connection with other circumstances, in determining the question whether or not a partnership exists between the parties. (*Fulton* v. *MacCracken*, 18 Md. 544.)

In deciding this case the Appellate Court well say in their opinion:

The fact that the business was conducted in the name of "A. Haug & Son" coupled with the fact that Andrew Haug and his son, Martin, each personally gave his attention to the business, raises a strong presumption that they were copartners in fact, and, while such evidence alone is not conclusive, we are not able to say that it, with other strong evidence, produced by appellee, tending to establish the fact of a partnership, is overcome by appellant's witnesses, though more numerous than the witnesses produced by appellee. We are unable to say the finding of the chancellor is not supported by the greater weight of the evidence.

It was shown in evidence, that the appellant, in the lifetime of his son, Martin, spoke of the latter as being his partner. In a suit brought against the firm of A. Haug & Son, the appellant testified that he and his son, Martin, were partners. Witnesses testified that they were told by appellant that his son, Martin, was his partner.

After the decease of Martin Haug, the appellant stated to several persons, who approached him upon the subject of buying goods, that he was not prepared to do anything in that direction until he effected a settlement with the widow of his son. In this connection he also stated that he did not know whether his son's widow, the present appellee, would continue in the business or not.

On the other hand, quite a number of witnesses say that they were told by Martin Haug in his lifetime that he was not a partner in the firm. On some occasions when this statement was made by Martin, it was in an answer to the applications of customers who desired to purchase goods upon credit. In such cases he would not infrequently refer them to his father, saying that he had no interest in the matter.

It thus appears that the testimony as to the existence of the partnership is conflicting. It is unnecessary for us to examine and discuss this testimony. Upon the trial below, all the witnesses upon both sides testified orally. They were seen by the chancellor, and their manner of testifying and their credibility were considered by him. The question of the existence of a partnership was a question of fact. This case, therefore, is one which calls for the application of the well-settled rule, often announced by this court, that "when the trial court has an opportunity of seeing the witnesses and of hearing their testimony as it is delivered orally, the findings of such court upon mere questions of fact, where the testimony is conflicting,

will not ordinarily be disturbed on appeal, unless such findings are clearly and manifestly against the preponderance of the evidence." (*Lane* v. *Lesser*, 135 Ill. 567; *Williams* v. *Thwing Electric Co.*, 160 *id.* 526; *Burgett* v. *Osborne*, 171 *id.* 227.) We have examined the testimony carefully and are unable to say that it preponderates in favor of the appellant. As the courts below have found the facts to be as testified to by the witnesses of the appellee, it is not our duty to disturb their findings.

We concur with the statement of the Appellate Court in their opinion to the following effect: "Without stopping to point it out, some of the evidence, given by witnesses for appellee, is more convincing to our minds that appellant fully understood that his son was a copartner with him in the mercantile business, carried on at Hunt City, than the evidence of other witnesses adduced to establish the contrary."

For the reasons above stated, the judgment of the Appellate Court, affirming the decree of the circuit court, is affirmed.

Judgment affirmed.

QUESTIONS

1. What test does this case lay down for determining whether or not a given relation is a partnership relation?
2. Are articles of partnership necessary to the existence of the partnership relation? What functions do articles of partnership perform?
3. Typically what matters are covered by partnership articles? Need they as a general rule be drawn up in any particular form?
4. Is a firm name necessary to the existence of a partnership? What functions does a firm name perform? In general what kind of name may be chosen as a firm name?
5. What matters should be carefully watched in drawing up articles for a limited partnership?
6. What rule is laid down by the case of *White* v. *Eiseman*, *supra*, page 289, with respect to the organization of a limited partnership?

SODIKER *v.* APPLEGATE

24 West Virginia Reports 411 (1884)

SNYDER, J. Suit in equity brought by William Sodiker against Lewis Applegate in June, 1879, in the circuit court of Brooke County to settle the accounts of an alleged partnership between the plaintiff

and defendant for running a grist- and flourmill, buying and selling grain and the products of said mill. The bill avers that by the terms of the partnership the defendant was to furnish the gristmill then owned by him and put the same in repair at his own expense, the plaintiff was to run and operate the mill, the funds for carrying on the business and keeping the mill in repair were to be furnished by the parties in equal portions and the profits were to be shared equally between them.

The defendant in his answer positively denies that any partnership of any kind existed between him and the plaintiff; he avers that while the plaintiff worked at his mill he did so as a hired hand, and that being without means and penniless he was employed to run the mill so long as he might do so satisfactory to the defendant and the customers of the mill. The cause was referred to a commissioner for an account, depositions taken and the commissioner reported that in his opinion no partnership existed, but, if the court should decide that the proofs established a partnership, he reported due to the plaintiff $126.87.

The plaintiff excepted to that part of the report which found that no partnership existed and the court by its decree of June 14, 1883, sustained said exception and decreed that the plaintiff recover from the defendant the said sum of $126.87 and costs. From this decree defendant appealed.

As I am clearly of opinion that no partnership existed between the plaintiff and defendant, it is only necessary to refer to the evidence in relation to that matter. The plaintiff in his deposition, after stating the terms of the partnership as alleged in his bill, says: "I did grind the wheat I bought with my own money and sold the flour on my own account and got the money. The wheat that Lewis Applegate bought I ground, took the toll from, and Applegate sold the flour on his own account. All the other grain that came into the mill was disposed of in the same way." He exhibits with his own deposition, and testifies to their correctness, certain accounts for work done by him and for bills paid for repairs to the mill, for boarding hands and for money paid for wheat, all of which are made out in his name against the defendant. The one-half of these accounts is what constitutes the sum found by the commissioner and on which the decree against the defendant is based. There are no credits on any of these accounts and no charges of any kind in favor of the defendant. Nothing appears as to the business of the alleged partnership. No charges in favor of or against it. In fact there is not in the evidence or the accounts

filed anything having any relation to the affairs of any partnership or anything to show that any partnership business was done from which any profits or losses could have arisen. If any partnership existed the facts altogether fail to show it. The accounts filed and relied on by the plaintiff are simply charges alleged to be due to him individually from the defendant. They are made out not against any firm but against the defendant personally. They, therefore, disclose on their face that the plaintiff did not regard them as partnership accounts, but merely as items due to him from the defendant for work done, money paid, etc., for the use of the defendant as an individual. For these claims, if they be just, the plaintiff has a plain and adequate remedy by action of *assumpsit* at law.

The plaintiff was the person who had charge of the business and, if there was any partnership, he was the partner to render an account and not the defendant. There are no allegations or proofs anywhere in the record that there are any assets or debts belonging to or due from the alleged partnership. If there were any assets or profits they ought to be in the hands of the plaintiff as the acting partner, and, therefore, cause for a suit might exist against him for an account, but it is difficult to conceive why he should have occasion to sue the defendant, who had nothing to do with the management of the alleged partnership. If the accounts and transactions disclosed in this record constitute a partnership and entitle the plaintiff to maintain this suit, then not only would every employee be a partner of his employer, but every person who had a private account against another could sue his debtor as a partner in a court of equity and recover.

It is apparent from the evidence in this cause that no partnership existed. The only agreement between the plaintiff and defendant is stated by the plaintiff when he says: "My agreement was, Mr. Applegate to furnish me a house to live in and I was to have the half. It was to be half and half between us. Inside repairs of the mill were to be done by me, and half of the expenses to be paid by each. Outside repairs to be paid by Lewis Applegate; was no agreement by us as to losses."

The evident meaning of this language as shown by the other testimony and facts is that the plaintiff was employed by the defendant to take charge of his mill as miller, and for his services in that behalf the plaintiff was to receive one-half the tolls or earnings of the mill. The half of the earnings or profits to which the plaintiff thus became entitled did not make him a partner. This merely constituted the

manner of payment and the measure of his compensation for his service as miller.

To constitute a partnership between the parties who share in the profits, the interest in the profits must be mutual; that is, each person must have a specific interest in the profits as a principal trader; he is not a partner if he merely receives out of the profits a compensation for his services as an agent, employee, or servant. Collyer on *Part.*, section 31. Thus, where A purchased goods for an adventure on the credit of B, and it was agreed, "that, if any profits should arise from the business, B should have one-half for his trouble, it was held that this was not a partnership between the parties." *Hesketh* v. *Blanchard*, 4 East, 144. In all cases there must be a participation as principal. If the persons merely occupy the relation of principal and agent, employer or employee, or factor, no partnership can be predicated upon the fact that such agent, employee, or factor receives a part or share of the profits for his services or other benefits conferred. This proposition is illustrated by numerous cases, among which are the following: *Berthold* v. *Goldsmith*, 24 How. 542; *Barckle* v. *Eckhart*, 1 Den. 341; *Bowyer* v. *Anderson*, 2 Leigh, 550; *Chapline* v. *Conant*, 3 W.Va. 507; *Dils* v. *Bridge*, 23 *Id.* 20; *Hanna* v. *Flint*, 14 Cal. 73; *Morgan* v. *Stearnes*, 41 Vt. 397.

In every partnership there is a community of interest, but every community of interest does not create a partnership. There must be a joint ownership of the partnership funds, or a joint right of control over them and also an agreement to share the profits and losses arising therefrom. Thus an agreement between A and B that A shall work B's farm upon shares and divide the produce does not constitute them partners *inter sese* or as to third persons. *Putnam* v. *Wise*, 1 Hill, 234. Nor are the owners of real estate who contract with mechanics to build a mill or other building upon their land partners *inter sese*, but either party paying more than his share of the expense of the construction, may recover such excess of the other owner in *assumpsit*. *Porter* v. *McClure*, 15 Wend. 187.

It is unnecessary to illustrate further what particular facts and agreements do or do not constitute a partnership. The books are full of nice distinctions and definitions showing that it is often difficult to decide to which class the particular facts and circumstances assign cases. In the case before us, however, there is no such difficulty. Under none of the authorities or definitions could this be classed as a partnership.

I am, therefore, of opinion that the decree complained of must be reversed with costs to the appellant and the plaintiff's bill dismissed with costs.

QUESTIONS

1. What test does this case announce for determining whether a given relation between business associates is a partnership?
2. A and B are engaged in the milling business. C sues them as partners on a debt arising out of the business. He offers evidence that A and B are co-owners of the property, and that there is an agreement between them to divide gross returns of the business equally between them. Should the evidence be admitted?
3. A and B are engaged in the grocery business. A is the owner of all the property used in the business. C sues A and B as partners and offers evidence tending to show there is an agreement between the parties that B shall be entitled to one-third of the net profits. Should the evidence be admitted?
4. In the foregoing case, C offers evidence of an agreement that A and B shall share the profits and bear the losses of the business equally. Should the evidence be admitted?
5. To what extent is mutual agency to be considered a test of the existence of a partnership?
6. Can there be such a thing as a partnership between A and B in favor of creditors and no partnership as between themselves?

PEOPLE *v.* FORD

294 Illinois Reports 319 (1920)

DUNN, J. The Fifty-first General Assembly passed an act in relation to corporations for pecuniary profit, known as the General Corporation Act, which was approved on June 28, and became effective July 1, 1919. (*Laws of 1919*, p. 316.)[1] Section 4 provides

[1] SECTION 2. Corporations may be organized in the manner provided in this act for any lawful purpose, except for the purpose of banking, insurance, real estate brokerage, the operation of railroads, or the business of loaning money.

SEC. 4. Whenever three or more adult persons, citizens of the United States of America, at least one of whom shall be a citizen of this State, shall desire to form a corporation under this act, they shall sign, seal and acknowledge before some officer, competent to take acknowledgment of deeds, a statement of incorporation setting forth the following:

1. The names and postoffice addresses of the incorporators;
2. The name of the proposed corporation;
3. A clear and definite statement of the object or objects for which it is formed;
4. The period of duration;
5. The location of its principal office in this State, giving town, or city, street and number if any;
6. The number of shares into which the capital stock is to be divided, whether all or part of the same shall have a par value, and if so, the par value thereof which

that "whenever three or more adult persons, citizens of the United States of America, at least one of whom shall be a citizen of this state, shall desire to form a corporation under this act, they shall sign, seal, and acknowledge before some officer, competent to take acknowledgment of deeds, a statement of incorporation setting forth the following:" (Here follow thirteen paragraphs stating the facts to be contained in the statement.) The section closes with the sentence that "such statement shall be filed in duplicate in the office of the Secretary of State on forms prescribed and furnished by the Secretary of State." Section 5 provides that "upon the filing of such statement,

---

shall not be less than five dollars, nor more than one hundred dollars, per share, and whether all or part of the same shall have no par value, and, if there is to be more than one class of stock created, a description of the different classes, the number of shares in each class, and the relative rights, interests and preferences each class shall represent;

7. The names and addresses (giving street and number) of the original subscribers to the capital stock, and the amount subscribed by each;

8. The total amount of authorized capital stock;

9. The amount of such stock which it is proposed to issue at once (which shall not be less than one thousand dollars);

10. The payment of at least one-half of the capital stock having a par value and of not less than five dollars per share for each share of capital stock having no par value, which it is proposed to issue at once, with a description of the nature and value of property, if any, paid for such capital stock;

11. The number, names and postoffice addresses of the directors, by street and number, at least one of whom shall be a resident of this State and the term for which elected;

12. In the case of a building corporation, a specific and definite description of the site for such building;

13. Any other provisions, not inconsistent with law, for the regulation of the business and the conduct of the affairs of the corporation, and any provisions creating, defining, limiting and regulating the powers of the corporation, the directors and the stockholders or any class or classes of stockholders. Such statement shall be filed in duplicate in the office of the Secretary of State on forms prescribed and furnished by the Secretary of State.

SEC. 5. Upon the filing of such statement, the Secretary of State shall examine the same, and, if it is in conformity with the provision of this act, he shall indorse thereon the word "filed" followed by the month, day, and year of such filing. Upon such filing the corporation shall be deemed fully organized and may proceed to business.

The Secretary of State shall also issue a certificate of incorporation to the incorporators, making a part of such certificate a copy of all papers filed in his office, using for that purpose duplicate copies, if any, filed therein, duly authenticated under his hand and the seal of State. A copy of such certificate of incorporation shall be prepared and filed by the Secretary of State in his office.

the Secretary of State shall examine the same, and, if it is in conformity with the provisions of this act, he shall indorse thereon the word 'filed' followed by the month, day and year of such filing. Upon such filing the corporation shall be deemed fully organized and may proceed to business." On September 5,1 919, a certificate of incorporation of the Washer Maid Co., was filed in duplicate in the office of the Secretary of State. The attorney-general afterward, by leave of the court, filed in the circuit court of Cook County an information in the nature of *quo warranto* against E. E. Ford, A. J. Fisher, and C. R. Gilbert, charging them with having unlawfully usurped, intruded into, held, and executed the office of directors of a pretended corporation known as the Washer Maid Co. under color of a void and illegal certificate of incorporation, and calling upon them to show by what warrant they exercised such privileges. The respondents filed a plea showing the various steps taken for the organization of the corporation, setting forth in *haec verba* the statement filed by them, alleging that it was made on forms prescribed and furnished by the secretary of state, which were executed and acknowledged by the respondents, and that the respondents had in all respects complied with the requirements of the General Corporation Act. The attorney-general demurred and for special cause of demurrer showed that the respondents in their statement of incorporation did not sign, seal, and acknowledge the same, but, on the contrary, failed to seal the same or to affix their seals to said statement of incorporation, as required by the General Corporation Act. The statement set forth in the plea shows the signatures of the respondents as follows:

E. E. Ford
A. J. Fisher
Chas. R. Gilbert
} *Incorporators*

The word "seal" does not appear, nor are there any letters, scrawl, or marks which might be regarded as a seal unless it is the bracket which joins the names, and neither the statement itself nor the certificate of acknowledgment contains any reference to a seal. The court overruled the demurrer, and the attorney-general electing to stand by it, the information was dismissed. An appeal was taken, and at the June term the cause was submitted with a request by both parties for an early decision because of the public importance of the question involved. It was stated that more than 4,300 corporations had been organized under the new act; that the statement of

the incorporation in each case was made upon the form prescribed and furnished by the secretary of state and was identical with the form used in this case, and that the incorporation of each of those corporations was subject to the same infirmity as that alleged against the appellees. The fees paid to the secretary of state amounted to more than $600,000 and annual franchise taxes to a large amount were about to fall due on July 1. Recognizing the public inconvenience which would arise from a prolonged uncertainty as to the legality of the organization of these corporations we announced orally our judgment affirming that of the circuit court, stating that the reasons would be given in an opinion to be filed later.

The question presented was whether the requirement that the incorporators shall seal the statement is mandatory or directory. It was argued on behalf of the people that the requirement of the seal is a condition precedent to the legal existence of a corporation. A somewhat similar question arose early in the history of the state in the case of *Cross* v. *Pinckneyville Mill Co.* 17 Ill. 54. The act of 1849 to authorize the formation of corporations for manufacturing, agricultural, mining, or mechanical purposes provided that any three or more persons desiring to form a company for such purpose should make, sign, and acknowledge and file "in the office of the clerk in the county in which the business of the company should be carried on and a duplicate thereof in the office of the Secretary of State, a certificate in writing," in which should be stated the name of the company and other facts mentioned in the statute. It was further provided that when the certificate should have been filed as aforesaid the persons who should have signed and acknowledged, and their successors, should be a body politic and corporate. In the case mentioned the duplicate certificate of organization had not been filed in the office of the secretary of state, but the court held that fact unimportant to defeat the organization or rights growing out of it; that there is a well-settled distinction between mandatory and directory provisions, and that carrying out the true intention of the legislature and effectuating the object of the law would not be promoted by strict technical construction, converting every direction and detail of power into a mandatory prerequisite of corporate existence. More recently a question arose as to the effect of the failure to mail notices of the meeting of subscribers of the capital stock to elect officers, as required by section 3 of the Corporation Act of 1872. We said: "The statute prescribes a certain course to be pursued in

organizing a corporation in this State. It does not necessarily follow, however, that any departure from that course will prevent a corporation from becoming one *de jure*. Whether or not such departure will have that effect depends upon the nature of the provision which is violated. If it is a mandatory provision, a failure to substantially comply with its terms will prevent the corporation from becoming one *de jure;* but if the provision is merely directory, then a departure therefrom will not have that consequence." It was held that it was immaterial whether or not notice had been given in the manner directed by the statute, the persons entitled to notice having waived it and actually attended the meeting, so that the purpose of the statute in requiring the notices to be given was accomplished. (*Butler Paper Co.* v. *Cleveland*, 220 Ill. 128.) The court there cited the case of *Newcomb* v. *Reed*, 12 Allen, 362, in which the legality of a corporation was questioned where the call for the first meeting was signed by only one of the persons named in the act of incorporation instead of a majority, as required by the statute of Massachusetts, and it was held that "the organization was not strictly regular but can hardly be considered even as defective." In contrast with this case, an illustration of the distinction between mandatory and directory provisions is furnished by another case in the same court (*Utley* v. *Union Tool Co.*, 11 Gray, 139), in which the articles of agreement of the incorporators did not fix the amount of the capital stock or set forth distinctly the purpose for and the place in which the corporation was establishd, the court saying: "There is an obvious reason for making such an organization by written articles of agreement a condition precedent to the exercise of corporate rights. It is the basis on which all subsequent proceedings are to rest and is designed to take the place of a charter or act of incorporation, by which corporate rights and privileges are usually granted." In *Kwapil* v. *Bell Tower Co.*, 55 Wash. 583, it was held that where a corporation was organized pursuant to a statute except that it did not execute its articles in duplicate and retain a copy in its office, there was a substantial compliance with the law so as to make it a corporation *de jure*.

The requirement of a seal in the execution of documents by individuals has become a mere formality. It means nothing. Private seals no longer exist as a means of execution of specialties, for even an individual scrawl is not required. In most deeds the word "seal" is printed on the blank form which is used and the grantor does not

know whether he has used a seal or not. It depends upon whether the word was printed on the paper or not. The solemnity of the sealed instrument is purely Pickwickian and no longer represents an idea. While courts of law in this state cannot disregard the legal quality of the sealed instrument, courts of equity frequently relieve parties from the difficulties arising from the application of the rigid rules of the common law to such instruments. We may look to the intention of the statute in determining the effect of an omission to add the seal. The purpose is to make a public record of the corporation, the definition of its powers, the amount of its stock, the names of its stockholders, its location, and other facts, in connection with it which are of interest to the public to know and of the state in its supervision over corporations to be acquainted with. The addition of a seal is of no importance for these purposes. It is not of the essence of the thing to be done and no prejudice can result from its omission. The essential act of making the statement, though not in the precise manner indicated, accomplishes the substantial purpose of the statute, and that is sufficient. It would not be carrying out the intention of the legislature to hold that the addition of a scrawl by the signers of the statement is mandatory and its omission invalidates the incorporation.

For these reasons the judgment of the circuit court was affirmed.

Judgment affirmed.

QUESTIONS

1. Trace the necessary steps in the organization of a corporation under the act referred to in the principal case.
2. At what moment does a corporation come into existence under this act?
3. Why does this act exclude from its provision certain corporations? Do you infer from this exclusion that such corporations cannot be organized?
4. What is the general purpose of the requirements outlined in this act for the organization of a corporation?
5. What does the court mean in the principal case by mandatory provisions? by directory provisions? What is the effect of a failure of the incorporators to comply with directory provisions? with mandatory provisions?
6. What is meant by a *de jure* corporation? What are the essential requirements of a *de jure* corporation?

SOCIETY PERUN *v.* CITY OF CLEVELAND

43 Ohio State Reports 481 (1885)

On January 28, 1874, the city of Cleveland conveyed to Perun (an incorporated school and literary society) certain real estate situated in that city, and to secure the unpaid purchase money therefor, Perun, on the same date, executed and delivered to the city its four promissory notes and a mortgage upon the premises conveyed. The city neglected to file this mortgage for record until October 21, 1879. In February, 1874, certain persons attempted to organize a mutual benefit association, under an act supplementary to an act to provide for the creation and regulation of incorporated companies, passed May 1, 1852 (Swan & Co. St. 271), passed April 20, 1872 (69 Ohio Laws 82), under the corporate name of "Society Perun." Thereafter, in May, 1874, Perun delivered to Society Perun its deed purporting to convey to the latter the premises theretofore mortgaged to the city. From that time forward and prior to the filing of the city's mortgage for record, Society Perun, acting in its supposed corporate capacity, from time to time executed and delivered deeds, mortgages, and executory contracts of sale, purporting to convey, incumber, and sell parcels of these mortgaged premises to various parties, who were made defendants in the action below, and some of whom (including Amasa Stone, a mortgagee, and who had paid taxes upon the premises mortgaged to him) are cross-petitioners in error.

Thereafter, in June, 1880, in a proceeding in *quo warranto* in this court, instituted by the attorney-general, Society Perun was adjudged not to have become incorporated in comformity to the laws of this state, but that its pretended incorporation was in violation thereof; and it was accordingly ousted of all rights and franchises to be a corporation. These proceedings in *quo warranto* were had pending and prior to the final judgment in, the action below; which was bought by the city to foreclose her mortgage, and also to foreclose her supposed vendor's lien on the mortgaged premises, as against these subsequent grantees, mortgages, and purchasers. The cause was appealed from the court of common pleas to the district court, wherein it was tried upon the issues, the court finding, among other things, that, as to the city of Cleveland, Society Perun was not a corporation either in law or in fact, and that the conveyance to it by Perun was void as against the city; and that the mortgages and other liens and claims of all the defendants (except the lien of Amasa

Stone for taxes and the claims of certain defendants for improvements on the premises) were subsequent and inferior to the lien of the city, in whose favor the court adjudged the second lien, and subsequent only to the lien of Amasa Stone for taxes paid by him, but of equal rank and merit with the holders of liens for expenditures on account of improvements above mentioned.

By the judgment in the *quo warranto* proceeding it was by this court in form adjudged that the defendants (the pretended incorporators), ever since their pretended incorporation, had unlawfully and without authority exercised the franchise of, and usurped the right to be, a body corporate; that the pretended organization of these defendants as a corporation was wholly void and of no effect, and vested in them no corporate rights, powers, privileges, or franchises of any description whatever. The sole ground upon which this judgment of ouster was rendered, was that while the statute requires that they should set forth in their certificate of incorporation (among other things) the manner of carrying on the business of the association, the attempted compliance with this requirement was in these words: "Third. That the manner of carrying on the business of said association shall be such as may be from time to time prescribed by the by-laws of such association: provided, that the same shall not be inconsistent with the laws of the state of Ohio."

Upon the trial below the plaintiff gave in evidence, against the objection of defendants, the record of the *quo warranto* proceedings. The defendants offered in evidence the writing which was filed with the secretary of state as the certificate of incorporation of Society Perun. They also offered to prove that the pretended incorporators proceeded to comply strictly with requirements of the statutes; that the elected trustee prepared a certificate of incorporation stating explicitly the manner of carrying on the business; that this was forwarded to the secretary of state, who submitted it to the attorney-general for examination and approval; that the secretary of state returned this paper with another form of certificate, which had been approved by the attorney-general and secretary of state, and which was the identical certificate actually filed with the secretary of state, and under the supposed authority of which an organization was in good faith attempted, and that they proceeded in good faith to act and transact its business under the supposed authority of such incorporation. All this was excluded, and the defendants excepted. To reverse this judgment the present proceeding is prosecuted.

The alleged errors chiefly relied upon are the exclusion of the evidence offered to prove an attempt, in good faith, to incorporate Society Perun; the finding and holding of the court that Society Perun had never been, in law or fact, a corporation; that as against the city the deed from Perun was void; and adjudging the city's lien to be prior to the rights and liens of Society Perun and its mortgagees, grantees, and purchasers.

Owen, J. The defendants below, conceding that Society Perun had never been a corporation *de jure*, maintain that the court below should have permitted them to prove that such society was a *de facto* corporation; that it attempted in good faith to become a body corporate; proceeded to act and transact business in good faith under the supposed authority of incorporation; and that its acts ought not to have been declared to be wholly void as against the city of Cleveland. The judgment of ouster was an adjudication between the state and the society upon the right of the latter to exercise corporate franchises. For the purposes of such adjudication, it was competent for this court to consider and determine what had been its status from its first attempt to incorporate. But it had no power to pass upon or determine the rights of parties not before it. It was not competent for this court to determine in that proceeding that Society Perun had never been a corporation *de facto*, or that its acts and business transactions, under the color of its supposed charter powers, were void. The authority of the court in that behalf was derived from section 5774, Rev. St., which provides: "When a defendant is found guilty of usurping, intruding into, or unlawfully holding or exercising an office, franchise, or privilege, judgment shall be rendered that such defendant be ousted and altogether excluded therefrom, and that the relator recover his costs."

When the court had excluded the society from its franchises to be a corporation, it exhausted its jurisdiction over the subject-matter. It had no power to speak concerning whatever rights may have been acquired by the society as a corporation *de facto*, or by third parties in their transactions with it as an acting corporation.

It is conceded by the city that parties who had recognized the existence of the society by their transactions with it as a supposed corporation are estopped to deny its corporate existence. But it is maintained that the city, having engaged in no transactions with it, is free to challenge its existence as a corporation, *de facto* as well as *de jure*. The argument is that "no case can be found where it is

held that there is a corporation *de facto* against persons who have in no way recognized its existence as a corporation"; and that "the notion of a *de facto* corporation is based on the doctrine of estoppel; when estoppel cannot be invoked, there can be no *de facto* corporation." The theory that a *de facto* corporation has no real existence, that it is a mere phantom, to be invoked only by that rule of estoppel which forbids a party who has dealt with a pretended corporation to deny its corporate existence, has no foundation, either in reason or authority.

A *de facto* corporation is a reality. It has an actual and substantial legal existence. It is, as the term implies, a corporation. "It is a self-evident proposition that a contract cannot be made with a corporation unless the corporation be in existence at the time. A real contract with an imaginary corporation is as impossible, in the nature of things, as a real contract with an imaginary person. It is essential, therefore, in order to establish the existence of a contract with a corporation, to show that the corporation was in existence, at least *de facto*, at the time the contract was made." Mor., *Priv. Corp.* section 137. It is bound by all such acts as it might rightfully perform as a corporation *de jure*. Where it has attempted, in good faith, to assume corporate powers; where its proceedings in that behalf are colorable, and are approved by those officers of the state who are authorized to act in that regard; where it has honestly proceeded for a number of years, without interference from the state, to transact business as a corporation; has been reputed and dealt with as a duly incorporated body, and valuable rights and interests have been acquired and transferred by it—no substantial reason is suggested why its corporate existence, in a suit involving such transactions, should be subject to attack by any other party than the state, and then only when it is called upon, in a direct proceeding for that purpose, to show by what authority it assumes to be a corporation.

Did the court err? This fairly presents the controlling and very important question: Was it competent to show, as against a party who has not estopped to deny its corporate existence, that Society Perun was, at the time of the transactions involved in controversy, a corporation *de facto?* In *Attorney-General* v. *Stevens*, 1 N.J. Eq. 369, the relator sought to enjoin the Camden & Amboy Railroad & Transportation Co., and others acting under its authority, from erecting a bridge over a navigable stream. The claim was that the act authorizing the corporation had been perverted and disregarded,

and that there was no legal incorporation. The relators were in no manner estopped from attacking the corporate existence of the respondent. The court held: "Where a set of men claiming to be a legally incorporated company, under an act of the legislature, have done everything necessary to constitute them a corporation, colorably, at least, if not legally, and are exercising all the powers and functions of a corporation, they are a corporation *de facto*, if not *de jure;* and this court will not interfere, in an incidental way, to declare all their proceedings void and treat them as a body having no rights or powers."

The chancellor, speaking for the court, said:

> Here, then, is a set of men, claiming to be a legally incorporated company, under the act of the legislature, exercising all the powers and functions of a corporation. They are a corporation *de facto*, if not *de jure*. Everything necessary to constitute them a corporation has been done, colorably, at least, if not legally; and I do not feel at liberty, in this incidental way, to declare all their proceedings void, and treat them as a body having no rights or powers. It has been seen that the court will not do this where a corporation properly organized has plainly forfeited its privileges; and there is but little difference in principle between the two cases. In both, the corporation is actually in existence, but whether legally and rightfully so is the question. And it appears to me that if the court can take cognizance of the matter in this case, it must in all others where it can be brought up not only directly but incidentally.

In *Thompson* v. *Candor*, 60 Ill. 244, Willets, in February, 1858, deeded to "Mercer Collegiate Institute," a body pretending to be a corporation, the tract of land in controversy. He died in March, 1858. In 1868 his heirs quitclaimed their interest in the land to Thompson, who filed a bill in chancery for the cancellation of the deed from Willett to the "Institute," alleging as one of the grounds of relief that the named grantee was not legally incorporated, had no capacity to take title, and that the deed was void. The court held:

> Where parties endeavored to organize a corporation for educational purposes, under the general law, adopt a name, elect trustees, and organize by electing a president and officers, and the trustees had acted for years in managing the property, had leased and mortgaged it, and expended a large sum of money in its improvement, these acts constitute it a corporate body *de facto*, and the regularity of its organization cannot be questioned collaterally. Such irregularity can only be questioned by *quo warranto* or *scire facias*.

THORNTON, J., says:

In 1856 an attempt was made to organize a corporation under the general incorporation law. A corporate name was selected, trustees were appointed, and an organization effected by the election of a president and proper officers. The trustees thus appointed acted for years in the general management of the property, leased and mortgaged it, and expended a large amount of money. Here, then, was a corporate body *de facto* which had been engaged in an undertaking involving important interests. The regularity of its organization cannot be questioned collaterally. An alleged non-compliance with the law can only be inquired into by the writ of *quo warranto* or *scire facias*.

There is no suggestion throughout the entire case of the rule of estoppel as an element affecting its disposition. In *Persse* v. *Willett*, 1 Robt. (N.Y.) 131, it is held that formal defects in proceedings to organize a corporation are not available to defeat an action brought by a corporation for trespass in wrongfully taking property out of its possession. See also, as illustrating the principle under discussion: *Smith* v. *Sheeley*, 12 Wall. 361, 20 L. Ed. 430; *Grand Gulf Bank* v. *Archer*, 8 Smedes & M. (Miss.) 151, 173; *Dunning* v. *Railroad Co.* 2 Ind. 438; *Dannebroge Min. Co.* v. *Allment*, 26 Cal. 286; *Searsburgh Turnpike Co.* v. *Cutler*, 6 Vt. 315; *Mitchell* v. *Deeds*, 49 Ill. 416; *Elizabeth City Academy* v. *Lindsey*, 28 N.C. 476, 45 Am. Dec. 500; *Darst* v. *Gale*, 83 Ill. 136; *Rondell* v. *Fay*, 32 Cal. 354; *Dewitt* v. *Hastings*, 40 N.Y. Super. Ct. 463; *Rice* v. *Railroad Co.* 21 Ill. 93; *Commissioners* v. *Bolles*, 94 U.S. 104, 24 L. Ed. 46; *Banks* v. *Poitiaux*, 24 Va. 136, 15 Am. Dec. 706; *Goundie* v. *Water Co.* 7 Pa. 233; *Baker* v. *Backus*, 32 Ill. 79; *Tarbell* v. *Page*, 24 Ill. 46; *Thornburgh* v. *Railroad Co.*, 14 Ind. 499; *Tar River Nav. Co.* v. *Neal*, 10 N.C. 520; *Bear Camp River Co.* v. *Woodman*, 2 Greenl. (Me.) 404.

In *Jones* v. *Dana*, 24 Barb. (N.Y.) 395, it was held that if a company has in form a charter authorizing it to act as a body corporate, and is in fact in the exercise of corporate powers at the time of taking a note from an individual, it is, as to him and all third persons, a corporation *de facto*, and the validity of its corporate existence can only be tested by proceedings in behalf of the people.

In the case at bar, the certificate which was last filed by the society embraced a full statement of the objects of incorporation and indicated what the nature of its business must necessarily be, and was strongly suggestive of the manner in which it must necessarily be transacted; and while it is not our purpose to call in question the

action of this court in the *quo warranto* proceedings, we have no hesitation in saying that if we were now called upon to determine whether the corporate life of Society Perun should be taken, the question, upon the facts offered in proof, would not be free from doubt and difficulty. It is very clear that the proceedings to incorporate were colorable; and so far as this fact is a test of the existence of a corporation *de facto*, it is most amply established. That there was proof of user is manifest from the evidence, which was received without objection. That the judgment of ouster did not and could not have a retroactive effect upon the rights of the society, and of the parties who had dealt with it during its *de facto* existence, is suggested by the opinion of WRIGHT, J., in *Gaff* v. *Flesher*, 33 Ohio St. 115. The evidence which was offered and excluded would, if credited, have shown Society Perun capable of holding and transferring the legal title to the lands in controversy. *Walsh* v. *Barton*, 24 Ohio St. 43; *Darst* v. *Gale*, 83 Ill. 136; *Shewalter* v. *Pirner*, 55 Mo. 218; *National Bank* v. *Matthews*, 98 U.S. 628, 25 L. Ed. 188; *Goundie* v. *Water Co.*, 7 Pa. 233; *Barrow* v. *Nashville, etc. Co.*, 9 Humph. (Tenn.) 304; *Kelly* v. *People's Transp. Co.*, 3 Or. 189; *Bogardus* v. *Trinity Church*, 4 Sandf. Ch. (N.Y.) 758.

The public and all persons dealing with the society were justified in assuming that the certificate filed with the secretary of state, and by him admitted to record in his office, had been approved by him and also by the attorney-general, as required by statute (69 Ohio Laws, 150), and that it so far conformed to all legal requirements that, as provided in section 2 of the act of incorporation (69 Ohio Laws, 80), "a copy duly certified by the secretary of state, under the great seal of the state of Ohio, shall be evidence of the existence of such association." It would seem that such approval, record and certificate, followed by uninterrupted and unchallenged user for nearly six years, of all of which proof was tendered, would constitute a corporation *de facto*, if such a body is, under any circumstances, entitled to legal recognition. The highest considerations of public policy and fair dealing protest against treating such an organization as a nullity and all of its transactions void.

The principle of these cases is to be distinguished from a case where a mere corporation *de facto* attempts to assert the power of eminent domain by the appropriation of private property to public use. It has been held that the exercise of this right (which is but a delegation of the sovereign power of the state) depends upon the

sufficiency and legal validity of the certificate of incorporation and public record of its organization. *Railroad Co.* v. *Sullivant*, 5 Ohio St. 276; *Atkinson* v. *Railroad Co.* 15 Ohio St. 21. The case of *Raccoon River Nav. Co.* v. *Eagle*, 29 Ohio St. 238, is relied upon by the defendant in error. It was an action to recover upon a stock subscription. A plea of *nul tiel* corporation was interposed. The plaintiff claimed to be organized under an act to authorize the incorporation of companies "for the purpose of improving any stream of water declared navigable by any law of the state of Ohio." On the trial the plaintiff offered in evidence a certificate by which it appeared that the company was formed for the purpose of improving, etc., Big Raccoon River. Unfortunately, there was no navigable stream in Ohio by that name. No other testimony was offered. There was no proof of user. There was no defect in the form of the proceedings to incorporate, but an attempt to organize and incorporate for a purpose impossible of accomplishment. There was neither a *de jure* nor *de facto* corporation. Judgment was properly rendered for defendant.

In excluding proof of what was actually done, looking to the incorporation of Society Perun, and of the subsequent acts of user, which was offered in evidence, there was error, for which the judgment in the first entitled case (as well as that in the *Same Plaintiff* v. *Hay and others*, which was tried with it, and involves the same general questions) is reversed. Numerous other questions are presented by the voluminous records in these cases, but as they all depend upon the one central and controlling question discussed above, and as the disposition here made of the cases must lead to a retrial in the light of the principles indicated in this opinion, they are not separately considered.

Judgment reversed.

QUESTIONS

1. What is a *de facto* corporation? What are the essential requirements for the existence of a *de facto* corporation?
2. In what respect did Society Perun fail to comply with the law so that it never became a corporation *de jure*?
3. A, B, and others organized under a general incorporating law and transacted business as a corporation for three years. In the meantime the law under which it was organized was declared unconstitutional. C sues A, B, and the others as partners on a note purporting to have been executed by the corporation. What decision?

4. It was contended in this case that the city of Cleveland was in a position to challenge the existence of Society Perun because it had never dealt with it as a corporation. On what theory was this contention made?
5. "The existence of a *de facto* corporation cannot be called into question in collateral proceedings." What is meant by this statement? How then can the existence of such a corporation be challenged?
6. What are the powers of a *de facto* corporation?
7. What justification is there for the recognition of a *de facto* corporation?

BERGERON *v.* HOBBS

96 Wisconsin Reports 641 (1897)

The defendants, under the name of Bayfield County Agricultural Association, employed several persons to perform labor in improving their grounds and in erecting fences and buildings. Time checks given by the defendants to such laborers, for such labor, were assigned to the plaintiff, who brings this action to recover their amount, alleging that the defendants were a copartnership. The defendants alleged that they were members of a corporation, and denied that they were copartners, or liable as such. This was the issue which was tried. It appeared upon the trial that articles of organization of the defendants as the Bayfield County Agricultural Association, and a certificate showing the election of officers, had been recorded in the office of the register of deeds of Bayfield, but were not on file there. They had been deposited with instructions to record and return them which had been complied with. When the testimony of both sides was in, the court directed a verdict for the plaintiff for the amount of the time checks. From a judgment on that verdict the defendants appeal.

NEWMAN, J. There are two questions raised on this appeal: (1) Was the mere recording of the articles of incorporation, with the certificate of the election of officers, without the intention or fact of the papers themselves remaining in the office, a sufficient compliance with the statute, so that the organization of the corporation became complete, as upon a proper filing of the papers themselves? and (2) if the recording was not sufficient for that purpose, are the defendants liable to the plaintiff only as a *de facto* corporation, or are they liable as copartners?

1. The statute (sec. 1460, Rev. St.) provides that, upon the filing of "a certificate of organization, with a copy of the constitution, in the office of the register of deeds of the county, such society shall have

all the powers of a corporation, necessary to promote the objects thereof." It cannot be doubted that the filing of the proper papers in the proper office is made, by the statute, a condition precedent to the vesting of corporate powers. The court may not be able to define clearly the respect wherein the mere recording and removal of the papers from the office fails to serve the full purpose which the legislature intended to accomplish by the filing of them. The legislature, no doubt, had good and sufficient reasons for its choice of means to promote its purpose. For the court it is not a question of equivalents. A literal filing of the papers is necessary because it is so written in the law. The term "filing" and the verb "to file," as related to this subject, include the idea that the paper is to remain in its proper order on file in the office. A paper is said to be filed when it is delivered to the proper officer, and by him received, to be kept on file. Bouv. *Law Dict.* The statute is plain and easy of observance. Valuable rights and exemption from personal liability are to be secured by its observance. It is no undue severity to require its strict observance. The defendants had not observed it, and had not secured corporate powers.

2. Had the defendants secured immunity from individual liability? No doubt, as a general rule, where an attempt to organize a corporation fails, by omission of some substantial step or proceeding required by the statute, its members or stockholders are liable as partners for its acts and contracts. Beach, *Private Corporations*, sections 16, 162*b;* Thompson, *Corporations*, sections 239, 416, 417. But the defendants' contention is that they are not within this rule, because they are, at least *de facto*, a corporation, and their right to be a corporation cannot be inquired into in a collateral action, but only in a direct action for that purpose by the state. The infirmity of the defendants' contention is in the assumption that they are a *de facto* corporation. In order to secure this immunity from inquiry into its right to be a corporation in a collateral action, its action, as a corporation, must be under a color, at least, of right. It is immaterial that they have carried on business under the supposed authority to act as a body corporate, in entire good faith. If they had not color of legal right, they have obtained no immunity from individual liability for the debts of the supposed corporation. Until the articles of incorporation are filed in the office of the register of deeds of the county, there is no color of legal right to act as a corporation. The filing of such paper is a condition precedent to the right to so act.

So long as an act, required as a condition precedent, remains undone, no immunity from individual liability is secured. 1 Thompson, *Corporations*, sections 226, 508.

The defendants are not a corporation either *de jure* or *de facto*, but are liable for the plaintiff's claim, as partners. It was not necessary to prove a copartnership by evidence. That was established by implication of law. Nor was it necessary to prove that the debt was unpaid. There was no presumption that it had been paid to be rebutted. The judgment of the circuit court is right, and must be affirmed. The judgment of the circuit court is affirmed.

MARSHALL, J. (Dissenting.) With the decision that the defendants failed to comply with all the conditions precedent to the corporate existence of the agricultural association I concur, but from the decision that because of such failure such association was not a corporation *de facto* I respectfully dissent, hence dissent from the conclusion reached that the defendants are personally liable to plaintiff, and that the judgment should be affirmed, but, on the contrary, hold that it should be reversed.

My brethren cite Beach, *Priv. Corp.*, section 162*b*, and 1 Thompson, *Corp.*, sections 239, 508, to the effect that, unless all the conditions precedent to the creation of a corporation are performed, there can be no corporation in fact, and that the members of the pretended corporation will be personally liable. Then sections 417 and 420 of Judge Thompson's work are cited, to the effect that, if the corporation never comes into being in fact, so as to be regarded as a corporation *de facto*, the persons who have assumed to contract in its name are personally liable. These sections seem to be tied together, in the opinion of the court, as if the two ideas are in harmony, when the contrary, to my mind, is manifestly true.

Thompson treats this subject in such a way as to naturally confuse one who attempts to follow him as authority. After saying, in sections 239, 508, in effect, that all the conditions precedent to the creation of a corporation must be complied with, in order that the members may escape personal liability, he says, in section 417, that the rule does not apply to corporations *de facto*, and in section 420, that where there is a corporation *de facto*—in other words, where the circumstances are such that a corporation might exist, and where the party seeking to charge the member individually has dealt with them as a corporation—he is estopped from setting up the fact that they are not a corporation *de jure*, in order to charge them personally.

From this confusion it is not to be wondered at that if a person tries to follow Judge Thompson he will be led inevitably into the position of holding that, unless all the conditions precedent to the existence of a corporation are complied with, personal liability of the members of the corporation will exist, though the rule does not apply if the organization be a corporation *de facto*. That comes from trying to harmonize conflicting decisions, that proceed on theories so opposite that harmony is impossible.

If we hold with Missouri, Arkansas, and some other states, that unless all the steps necessary to the creation of the corporation have been taken there is no corporate existence, and that the members of the association are personally liable, we, in effect, say that it is not sufficient to enable such members to escape personal liability to show that their organization is a corporation *de facto;* that nothing short of a corporation *de jure* will do. But if we adopt the growing doctrine, supported, as we shall show, by the overwhelming weight of authority in this country, that a person who contracts with a *de facto* corporation, the members of the latter and such person believing, in good faith, in its legal existence, such members cannot be held personally liable, then we concede, necessarily, that it is not essential to freedom from such liability that all the statutory requisites to the existence of a corporation be complied with, because, when that is done, the organization, obviously, is a not a corporation *de facto* only; it is a corporation *de jure*. This is too plain to admit of serious discussion.

While the decision in this case, as I read the opinion of the court, in one view, goes upon the ground that the members of a *de facto* corporation are not responsible personally, inasmuch as it may be held that the decision really is to the effect that personal liability exists because all the conditions precedent to a corporation *de jure* were not complied with, some reference to authorities on the subject of whether to escape such liability it is necessary that the corporation exist in fact may be proper.

The development of the law on this subject has been rapid in recent years in the direction of holding that the state only can challenge the legality of the exercise of corporate powers. The ancient doctrine was that all contracts made by a corporation in excess of its powers were void. That has not been changed, but the doctrine has grown up, and become well-nigh universal, that the state only can raise the question by proceedings to punish the corporation.

Our court is fully committed to such doctrine. *John V. Farwell Co.* v. *Wolf*, 70 N.W. 289. Following closely upon the growth of such doctrine as applied to transactions in excess of corporate powers, where there is no question as to the existence of the corporation, it has been extended, so as to prevent private persons, who have contracted with a *de facto* corporation, from questioning its existence; holding that sovereign power only can raise that question. This court having fully adopted the doctrine where there is a corporation in fact, how it can be rejected where the corporation is *de facto* merely, is not perceived, inasmuch as a controlling reason for it in the one case applies equally to the other. In both cases there is an exercise of powers that can only be lawfully exercised by sovereign authority; hence the unauthorized exercise of power constitutes a public offense, not against any individual, but against the sovereignty of the state.

From the foregoing, we are warranted in asserting that, by well-settled principles of law, the agricultural association with whom plaintiff contracted was a *de facto* corporation. Every element necessary to make it such appears clearly by the record. There was a law under which it might have existed. The association prepared their constitution, and adopted it in the form of ordinary articles of organization, under the general incorporating act, and by mistake they filed it for record, and it was recorded and returned, instead of filing it to be left in the office, as the law requires. They supposed that they had corporate existence by reason of the recording of their articles of organization. They assumed to act as a corporation, and exercised corporate powers for a considerable length of time, and, for aught that appears, in the utmost good faith. Certainly the existence of the law, the making and recording of articles of organization, in an honest attempt to become a corporation, and the honest assumption and exercise of corporate powers, prima facie establishes good faith. Plaintiff supposed that the corporation was a corporate body till long after his contract relations with the association ceased. Now to allow him to come and say that the corporation did not exist which all supposed had legal existence, that, though the officers of the association and plaintiff contracted for a corporate liability on the part of the former, it shall be held, nevertheless, that the members of such association are bound as partners, in direct violation of the well-settled law that such an association, under the circumstances, was a *de facto* corporate body; that, as between the parties, the

relations are the same in all respects as though the corporation had a *de jure* existence, and contrary to the settled doctrine, as I believe, of this and most other courts, is what the judgment of this case does, in my opinion.

I think the judgment of the circuit court, holding the defendants liable as partners, was wrong, and that it should be reversed, and the cause remanded for a new trial.

QUESTIONS

1. What statutory provision did the incorporators fail to comply with in this case? What was the purpose of the provision? Was not the purpose of the provision met in spirit by what the incorporators did?
2. If the view of the majority of the court is accepted, is there any real difference between a *de facto* corporation and a *de jure* corporation?
3. The law states that the articles of incorporation shall name "the principal place of business." A, B, and C state in their articles that the business is to be carried on in Chicago but do not state that Chicago is the "principal place of business." Is this a *de jure* corporation? If not, is it a *de facto* corporation?
4. The law provides that the articles shall state "the duration of the corporation, not to exceed fifty years." The incorporators state in their articles that the corporation is organized for a period of ninety years. Is this a *de jure* corporation? Is it a *de facto* corporation?
5. The law provides that the articles shall be signed and acknowledged by the incorporators before some officer authorized to administer an oath. Five incorporators of a certain corporation sign the articles, but only four acknowledge them. Is the organization a *de jure* corporation? Is it a *de facto* corporation?
6. It is said that, in addition to other requirements, the incorporators must show a corporate user to establish the existence of a corporation *de facto*. Why is this necessary? What constitutes a corporate user sufficient to satisfy this requirement?

FLETCHER *v.* PULLEN

70 Maryland Reports 205 (1889)

MILLER, J. The plaintiffs who are nursery men in Milford, Delaware, sued Bramble and Fletcher as partners in the same business at Cambridge in this state, for fruit trees sold and delivered to them in the autumn of 1886. Bramble died before the trial, and Fletcher defended upon the ground that he was not a partner. The exceptions relate mainly to the admissibility of evidence upon the question, not whether Fletcher and Bramble were actually partners *inter sese*, but

whether Fletcher had held himself out, or had permitted himself to be held out, as a partner, so as to become responsible to third parties.

The law on this subject, well established by authority, may be stated thus: The ground of liability of a person as partner who is not so in fact, is that he has held himself out to the world as such, or has permitted others to do so, and by reason thereof is estopped from denying that he is one as against those who have, in good faith, dealt with the firm or with him as a member of it. But it must appear that the person dealing with the firm believed, and had a reasonable right to believe, that the party he seeks to hold as a partner was a member of the firm and that the credit was, to some extent, induced by this belief. It must also appear that the holding out was by the party, sought to be charged, or by his authority or with his knowledge or assent. This, where it is not the direct act of the party, may be inferred from circumstances, such as from advertisements, shop-bills, signs or cards, and from various other acts from which it is reasonable to infer that the holding out was with his authority or with his knowledge or assent. And whether a defendant has so held himself out, or permitted it to be done, is in every case a question of fact, and not of law. These general rules apply to the present case.

The evidence shows that there was, in or near Cambridge, a fruit farm and nursery on about fifteen acres of Fletcher's land which Bramble had occupied and managed from the year 1881 to 1887. The plaintiffs then proved that in October and November, 1886, they received several letters, postal-cards, telegrams, and circulars from Cambridge signed "Fletcher and Bramble," representing them to be partners, and the envelopes in which the letters were inclosed were stamped with the same firm name. These letters contained orders for fruit trees, and the first of them gave a reference to a Mr. Van Horse, formerly of Milford, but then residing in Cambridge. The plaintiffs not knowing the firm, nor by whom the letters were written, wrote to Van Horse and others inquiring as to its credits and standing, and in reply received information to the effect that Fletcher was entirely responsible, but that Bramble was worth nothing. Upon this information, and receiving no intimation that Fletcher was not a partner, they filled the orders and delivered the trees, relying upon his credit. Each item of this testimony was excepted to as it was offered, upon the ground that these letters, circulars, and envelopes were written and gotten up by Bramble without Fletcher's knowledge or consent. We think, however, they were all admissible, not

because the acts and declarations of Bramble would bind Fletcher, as of course they would not unless he was an actual partner, but for the purpose of showing that the plaintiffs believed, and had good reasons to believe that he was a partner, and that they trusted the supposed firm upon the faith of his responsibility. To prove this was an important link in the plaintiffs' case, and evidence tending to prove it was in our opinion admissible.

The plaintiffs then proved that an advertisement signed "Fletcher & Bramble," calling attention to their nursery, offering their trees for sale, and soliciting from the public continuance of confidence and orders, was published in two weekly newspapers of Cambridge where Fletcher lived for three months during the year 1884. In one of these papers there was also a local notice of the advertisement. They were also prepared, inserted, and paid for by Bramble without Fletcher's knowledge, but it was proved that during the time of their publication he was a subscriber to both papers, and they were regularly sent to him. There is also clear proof that he actually knew of them while they were being published and never inserted in either of the papers any denial of the partnership. From all this it was competent for a jury to infer that he was held out to the public by Bramble as a partner, with his knowledge and assent, and we are of opinion the plaintiffs were entitled to prove this though they never saw the advertisements and were not influenced by them in trusting the firm. They had already proved they had so trusted it in good faith, and upon good grounds, and we think they had the right to resort to these antecedent advertisements and to this proof for the purpose of showing that Fletcher had been so held out to the public with his knowledge and assent. It was evidence to go to the jury upon that subject, and if uncontradicted would have made him a partner, at least, as to all third parties who had trusted the firm in good faith upon that supposition. Having knowledge of these advertisements it was his duty to deny the partnership if he wished to escape liability. But what was he to do and how much? We do not say he was under a legal obligation to publish a repudiation of the partnership in the same newspapers or in any other, though this would seem to be a very obvious and the most efficient mode of proclaiming such denial, and the fact that he failed to do so was a circumstance to go to the jury. But we take it that the rule upon this subject stated by a very eminent jurist is reasonable and just: "If one is held out as a partner and he knows it, he is chargeable as one unless he does all that a reasonable and honest man

should do under similar circumstances, to assert and manifest his refusal and thereby prevent innocent parties from being misled." Parsons on *Partnership*, 134.

It follows that the court below was right in admitting all the evidence offered by the plaintiffs and in rejecting the defendant's first prayer. In regard to his second, third, and fourth prayers all that need be said is that the propositions they contain are all embraced in his fifth prayer which the court granted, with a single modification to which we see no valid objection.

We come now to the rulings excluding certain evidence offered by the defendant to show and sustain his denial and repudiation of the partnership. His own testimony was to the effect that Bramble was simply his tenant of the land for the term of six years from 1881; that Bramble had a fruit tree nursery on the land, but he himself had nothing to do with it, and never entered into a contract of partnership with Bramble, either written or verbal, in the nursery business or any other; that he never held himself out as such partner, and never lent his name or authorized the use of it by Bramble with reference to this business or any other; that he never knew of the letters, circulars, and envelopes written and used by Bramble until they were produced in court at the trial; that the advertisements and local notice were inserted without his knowledge or consent, and he never knew anything about them until they appeared in the papers; that he never put himself to the trouble and expense of publishing in these papers or in any others a contradiction of the advertisements, but had on all occasions to town people and country people when the subject was mentioned to him, and often when it was not, denied the existence of any partnership, and repudiated the advertisements as unauthorized by him. All this was allowed to go in without objection but it is to be observed that he admits he knew of the advertisements which clearly and publicly proclaimed the partnership, and never published in any newspaper any denial of it. We have said he was under no legal obligation to make publication, but that it was his duty to do all that a reasonable and honest man should do under similar circumstances to manifest his denial. This is the important question in the case and it was one solely for the jury to determine. On this issue of fact he was entitled to adduce all the evidence he could, leaving it for the jury to decide whether upon the whole of it, they thought he had done all that a reasonable and honest man ought to have done. Under this rule he was entitled

to the benefit of any evidence in corroboration of his own testimony which tended to prove the publicity of his denial.

Now in addition to his own general evidence on this subject he offered to prove:

1. By the editor of one of the papers in which the advertisement and notice appeared, that when the witness called upon him to pay for the same, he refused to do so, repudiated all partnership with Bramble, declared he had nothing to do with Bramble's business, and would have nothing to do with his bills.

2. By the postmaster of Cambridge, that soon after the publication of the advertisements, witness delivered to Fletcher certain mail matter addressed to "Fletcher & Bramble," but he returned it unopened, and refused to accept the same, telling witness he had nothing to do with Bramble's business, and was no partner of his.

3. That in July, 1885, he and Bramble were sued as partners by the steamboat company before a magistrate in Cambridge on a bill for freight; that there was a crowd at the trial, and he resisted the suit and refused to pay the account, on the ground that he had nothing to do with Bramble's business; that the magistrate gave judgment in his favor, and the case was much discussed in the community, especially by the steamboat agent who made great complaint, because the magistrate had decided in his favor.

In our opinion these items of evidence should have been admitted. It is not for this court to pass upon their weight or effect, no matter how slight or inadequate as a denial of the partnership publicly proclaimed in the newspapers, we may deem them to be. This is a matter solely for the jury. Our duty is simply to determine the question of their admissibility as evidence, and we think the court erred in rejecting them.

We are also of opinion that the agreement, or lease as it is called, between Fletcher and Bramble, for the land upon which the nursery was carried on, should have been admitted. It was part of the defendant's case to prove that he was not an actual partner with Bramble. This agreement was admissible for that purpose, if he could show that by its true construction it merely created the relation of landlord and tenant between them.

The error of rejecting the items of evidence referred to, requires us to reverse the judgment and award a new trial. But in view of the fact that the court below, acting as a jury, found for the plaintiffs notwithstanding they had granted the defendant's fifth prayer, in

which all his own testimony in denial of the partnership was expressly submitted to the consideration of the judges, we think each party should be required to pay his own costs, both in this court and the court below.

Judgment reversed and a new trial awarded.

QUESTIONS

1. Would the court in this case have reached the conclusion that there was a partnership in case a controversy had arisen between Bramble and Fletcher?
2. X stated to P that D was a partner in his, X's, business. P extended credit to X in reliance on this statement. P sues D as a partner in the business. What decision?
3. For a year or more X had been using letter-heads on which D's name appeared as a partner in X's business. P extended credit to the business, relying on this fact. What are the rights of P against D?
4. X, with D's knowledge and acquiescence, represents that D is a partner in the business. P, in ignorance of this representation, extends credit to X. P sues X on the debt and joins D as a partner. What decision?
5. D, aware that X is holding him out as a partner, publishes a notice in the daily newspaper, which has a wide circulation in the territory in which X does business, disclaiming any connection with the business. P, knowing of X's representation but ignorant of P's disclaimer, extends credit to X. What are his rights, if any, against D?
6. A, B, and C are assuming to act as a corporation under the name of the Southside Express Co. although they have taken inadequate steps to incorporate their business. D executes a promissory note to them in the name of the Southside Express Co., reasonably believing that he is dealing with a corporation. Action is brought on the note in the name of the Southside Express Co., as a corporation. D contends that the action is improperly brought because the organization is not a corporation. What decision?
7. A, B, and C, in the name of the Southside Express Co., execute a note to P. P, at the time he accepts the note, reasonably believes that he is dealing with a corporation. P sues the Southside Express Co. on the obligation. A, B, and C contend that the action is improperly brought because the Southside Express Co. is not a corporation. What decision?
8. C brings proceedings to subject D's property to the payment of a debt of an alleged corporation of which D is a member. D opposes the proceedings on the ground that the incorporators of the alleged corporation so far failed to comply with the incorporating law that the organization never became even a *de facto* corporation. What decision?
9. What essential requirements must be shown to establish the existence of an estoppel corporation?

CHAPTER IV

FINANCING THE BUSINESS UNIT

1. In General

THE ROBINSON BANK *v.* MILLER

153 Illinois Reports 244 (1894)

The original bill in these consolidated causes was filed by certain persons, doing a banking business as partners under the name of the Robinson Bank, for the purpose of removing the three mortgages hereinafter named as clouds upon the title of Abner P. Woodworth, trustee for said bank, to four acres of land in Robinson in the county of Crawford. Upon the first trial in the circuit court all the mortgages were set aside. Upon appeal to the Appellate Court the decree of the circuit court was reversed, and the cause was remanded. The cause was heard a second time in the circuit court; and, at the second hearing, the mortgage to Lamport was set aside as fraudulent, and his cross-bill to foreclose the same was dismissed, but the two Emmons' mortgages were sustained as valid, and the prayers of the cross-bills and supplemental cross-bills to foreclose the same were granted by the entry of a decree of foreclosure. The second decree of the circuit court has been affirmed by the Appellate Court, and the present appeal is prosecuted from such judgment of affirmance.

MAGRUDER, J. The Robinson Bank, one of the appellants herein, claims that the mill property including the four acres of land upon which the mill was located, was partnership property belonging to the firm of Newton, Emmons & Miller, that, as such, it was first liable to be subjected to the payment of the partnership creditors, including the bank; that the mortgagees, Lamport, Walter and Willis, and Wiley S. Emmons, were individual creditors of Miller and John S. Emmons, and only entitled to such surplus as might arise out of the mill property after the payment therefrom of the firm debts.

Whether real estate, upon which a partnership transacts its business, is firm property or the property of the individual members of the firm, is oftentimes a difficult question to determine, and one upon which the authorities are not altogether uniform.

The mere fact of the use of land by a firm does not make it partnership property. (*Goepper* v. *Ginsinger*, 39 Ohio St. 429; *Hanchett* v. *Blanton*, 72 Ala. 423.) Nor is real estate necessarily the individual property of the members of a firm because the title is held by one member, or by the several members in undivided interests. (1 Bates on *Law of Partnership*, sec. 280.) Whether real estate is partnership or individual property depends largely upon the intention of the partners. That intention may be expressed in the deed conveying the land, or in the articles of partnership, but when it is not so expressed, the circumstances, usually relied upon to determine the question, are the ownership of the funds paid for the land, the use to which it is put, and the manner in which it is entered in the accounts upon the books of the firm. (1 Bates on *Law of Partnership*, sec. 280; 2 Lindley on *Part.* marg. p. 649; 17 *American and English Encyclopedia of Law*, p. 945, and cases in note.)

Where real estate is bought with partnership funds for partnership purposes, and is applied to partnership uses, or entered and carried in the accounts of the firm as a partnership asset, it is deemed to be firm property; and, in such case, it makes no difference, in a court of equity, whether the title is vested in all the partners as tenants in common, or in one of them, or in a stranger. (Parsons on *Partnership* [4th ed.], sec. 265; 1 Bates on *Law of Partnership*, sec 281; *Johnson* v. *Clark*, 18 Kans. 157; 17 *American and English Encyclopedia of Law*, p. 948, and cases cited.) If the real estate is purchased with partnership funds, the party holding the legal title will be regarded as holding it subject to a resulting trust in favor of the firm furnishing the money. In such case no agreement is necessary; and the statute of frauds has no application. (*Parker* v. *Bowles*, 57 N.H. 491; 1 Bates on *Law of Partnership*, sec. 281.)

In the case at bar, the land was not purchased with partnership funds. The undivided one-third interest bought by John S. Emmons was paid for by him with his own individual money. Miller also paid for the one undivided one-third interest, purchased by him, with his individual funds. None of the money of the firm of Newton, Emmons & Miller was contributed toward the purchase of the one-third interest held by Newton. Indeed, the proof shows, that the firm of Newton, Emmons & Miller was formed by an oral agreement after Emmons and Miller had bought their interests. Each partner here held the title to an undivided one-third part of the property. No entries were made upon the books of the firm showing that the real estate was

treated as firm assets. The evidence, however, does show that the property was bought for the purpose of being used in the milling business, and that, after its purchase, it was used for firm purposes and that the firm gave its notes to pay for repairs, and for placing new machinery in the mill upon the premises. Under these circumstances was the land partnership property, or the individual property of the partners holding as tenants in common?

It cannot be said that the land is firm property upon the theory of a resulting trust, because the money of the firm was not used to buy the property. Such a trust might exist in favor of the firm, regarding it as a person, if the partners had taken the legal title, and the firm had advanced the purchase money. The trust must arise at the time of the execution of the conveyance, and when the title vests in the grantee. Such could not have been the case here under the facts stated. (*Van Buskirk* v. *Van Buskirk*, 148 Ill. 9.) In view of the fact that the land was bought with individual, and not partnership, funds and was conveyed in undivided interests to the several partners, and in the absence of any agreement that it should be regarded as firm property, does the conduct of the parties in afterward forming a partnership, and using the property for partnership purposes, and repairing and improving the mill at the expense of the firm, make the land firm property in a court of equity? A negative answer to this question is found in many of the authorities.

The general doctrine of all these cases is, that a purchase of the land with partnership funds is necessary to make it firm property. Parsons in his work on *Partnership* (4th ed.) says: "Although it (real estate) be held in the joint name of two or more persons, if there be no proof that it was purchased with partnership funds for partnership purposes, it will be considered as held by them as joint tenants, or tenants in common; so, if not paid for by partnership funds, then, it is probably his property who pays for it, whatever use he permits to be made of it." (Secs. 265, 266.) In *Hanchett* v. *Blanton*, *supra*, the supreme court of Alabama says: "Steering clear of all cases of fraud or of the use by one partner, without the approbation of his associates, of partnership funds in the acquisition of real estate, the two facts must concur to constitute real estate partnership property—acquisition with partnership funds, or on partnership credit, and for the uses of the partnership." In *Thompson* v. *Bowman*, *supra*, the Supreme Court of the United States says: "In the absence of proof of its purchase with partnership funds for partnership

purposes, real property standing in the names of several persons is deemed to be held by them as joint tenants or as tenants in common." (*Buchan* v. *Sumner*, 2 Barb. Ch. 165.)

QUESTIONS

1. Does a partnership have capital stock? Does it have capital?
2. What constitutes the capital of a partnership? How is it acquired? How is it held?
3. A and B are partners in a teaming business. A buys a team of horses with his own money but uses them in the firm business. Can the horses be seized as firm property?
4. A buys real estate with firm money but takes title in his own name. Is the land to be regarded as individual or partnership property?
5. Since the liability of each partner is unlimited, what difference does it make whether a given piece of property belongs to the firm or to the individual partners?
6. What is meant by the *capital stock* of a corporation?
7. What is the difference between the *capital stock* and the *authorized capital stock* of a corporation?
8. What is the difference between the *capital* and the *capital stock* of a corporation?
9. How is the amount of the capital stock of a corporation determined? What determines the capital of a corporation?

EINSTEIN *v.* RARITAN WOOLEN MILLS

74 New Jersey Equity Reports 624 (1908)

Howell, V. C. The Raritan Woolen Mills was incorporated by a special act of the legislature of New Jersey entitled "An act to incorporate the Raritan Woolen Mills," which act was approved March 23, 1896, and is found in the laws of that year at page 536. The charter provides that the capital stock shall be $100,000, "with the privilege of increasing the same from time to time to any sum not exceeding $250,000." Capital stock to the amount of $150,000 has been issued and is outstanding. The directors have passed a resolution providing for the amendment of the company's charter by increasing the total capital stock of the company to $525,000, $150,000 of which shall be first preferred cumulative 7 per cent stock, and the remainder common stock. The resolution further provides that the present outstanding common stock of the corporation shall be converted into the first preferred cumulative 7 per cent stock which the

resolution provides for; so that when the change shall have been effected the capital stock of the corporation shall consist of $150,000 of preferred stock and $375,000 of common stock. The directors have called a meeting of the stockholders to vote upon the adoption by them of the resolution, and the complainant, who is one of the stockholders of the corporation, now files his bill to enjoin the corporation, its officers and directors, from increasing the capital stock or issuing any preferred stock or converting the present outstanding issue of $150,000 of common stock into a like amount of preferred stock, and restraining the stockholders from voting at the stockholders' meeting in favor of the directors' resolution. Two questions are raised: first, the power of the corporation without the universal consent of its shareholders to increase the amount of its capital stock; second, the right of the corporation to issue preferred stock and compel its substitution for the present outstanding common stock without the consent of all the shareholders. The charter of the corporation confers upon it the general powers and subjects it to the general restrictions contained in the Corporation Act of 1846 (*P.L.*, 1846, p. 16), and it may be sufficient, without further reference to the statute, to say that it contains no specific authority to a corporation organized under it to do any of the things that are attempted to be done in this case. The charter provides in so many words that the capital stock may be increased from time to time to any sum *not exceeding* $250,000.

This, I take it, is a limitation upon the power of the company which is part of the contract existing between the stockholders among themselves and between the stockholders and the corporation itself, and that it cannot be abrogated or avoided by the corporation or by its directors, or by any majority, however large, of its stockholders against the objection of the holder of a single share. This is on the ground that such action would violate that provision of the federal constitution which prohibits the states from passing any laws which impair the obligation of contracts. The decisions of the Supreme Court of the United States are the final authority on questions arising under this provision of the Constitution, because they are necessarily federal questions. In *Chicago City Railway* v. *Allerton*, 18 Wall. 233 (1873), the question which is now before the court arose for final decision in the Supreme Court of the United States. The appellant was a street railway company having a capital of $1,250,000 which it proposed to increase to $1,500,000. The appellee, Allerton,

objected and filed his bill to prevent the increase. The charter of the corporation provided the capital stock should be $100,000, and that this might be increased from time to time at the pleasure of the corporation, and that all corporate powers of the corporation should be vested in and exercised by the board of directors and such officers and agents as the board should appoint. The board of directors attempted to make the increase by a mere resolution of that body. Mr. JUSTICE BRADLEY, without attempting to decide questions which arose under the constitution and laws of the state of Illinois, affirmed the decree in favor of the complainant below upon the broad ground that a change so organic and fundamental as that of increasing the capital stock of the corporation beyond the limit fixed by the charter could not be made by the directors alone unless expressly authorized thereto. He says:

"Authority to increase capital stock of a corporation may undoubtedly be conferred by a law passed subsequent to the charter, but such a law should regularly be accepted by the stockholders; changes in the purpose and object of an association or in the extent of its constituency or membership involving the amount of its capital stock are necessarily fundamental in their character and cannot, on general principles, be made without the express or implied consent of the members." This case has been followed, and its authority has never been questioned. Its doctrine followed in *Scoville* v. *Thayer*, 105 U.S. 143, and in *Bank* v. *Railroad Co.*, 13 N.Y. 599; *Railroad Co.* v. *Schuyler*, 34 N.Y. 30; *Kent* v. *Quicksilver Mining Co.*, 78 N.Y. 182. I quote from the opinion of JUDGE FOLGER in that case:

> There is a power in this charter to alter, amend, add to or repeal, at pleasure, by-laws before made. It is argued from this that it was in the power of the corporate body, in due form and manner, to alter the by-laws which had fixed the amount of the capital stock and the number and relative value of the shares thereof. The power to make by-laws is to make such as are not inconsistent with the constitution and the law, and the power to alter has the same limit, so that no alteration could be made which would infringe a right already given and secured by the contract of the corporation. Nor was the power to alter, to the extent of affecting the contracted relative value of a share, reserved when the share was sold to the stockholder, so as to enter into and form a part of the contract. An alteration is a *pro tanto* repeal; but no private corporation can repeal a by-law so as to impair rights which have been given and become vested by virtue of the by-law afterwards repealed.

The reasoning of these cases goes to the question of the violation of the contract as alleged by the complainant, and it applies to the other matters mentioned in the resolution, namely, the creation of preferred stock and the compelling of the present shareholders to surrender their common stock and accept preferred stock in lieu thereof. It is true that at the time of the creation of this corporation there was an act in force (*P.L.*, 1860, p. 603) providing that manufacturing corporations might create two kinds of stock, viz., general stock and special stock, the latter at no time to exceed half the capital paid in, and subject to redemption with a fixed half yearly sum or dividend not exceeding 4 per cent before any dividend should be set apart or paid on the general stock. This act was repealed on April 9, 1875, without any reservation of any rights acquired under it, and, at any rate, if it were a part of the company's charter, it would not authorize the present action, for the reason that the rate of dividend provided for is 4 per cent, while the present plan contemplates dividends at the rate of 7 per cent.

All the other provisions of our statutes relating to the creation of preferred stock have been passed since the Raritan Woolen Mills was organized as a corporation, and it not appearing in the case that these subsequent provisions have been accepted by the shareholders as amendments to the charter, I feel obliged to hold that there is no authority for the creation of preferred stock without the consent of every shareholder. The same line of argument applies to the attempt of the directors to convert the present common stock into preferred stock. It is said on behalf of the company and its directors that the complainant cannot be compelled to convert his own stock into preferred stock, and that he therefore need not do it; that he may continue to hold it as common stock, and that inasmuch as one share of stock is like another, it can make no difference to him whether he holds his shares which have been theretofore authorized or whether he holds shares which shall be authorized by virtue of the resolution in question. The reasoning of Mr. Justice Bradley in the Allerton Case above cited seems conclusive on this point. He says:

> Second, as it respects the constituency or capital and membership. This is the next most important fundamental point in the constitution of a body corporate, to change it without the consent of the stockholders would be to make them members of an association in which they never consented to become such. It would change the relative influence, control, and profit of each member; even when the additional stock is distributed

to each stockholder pro rata it would often work injustice, because some of the stockholders might be unable to take their respective shares and might thus lose their relative interest and influence in the corporate concerns.

I take it that when Mr. JUSTICE BRADLEY speaks of the consent of the shareholders he means the consent of every shareholder, and that a mere majority, however large, would not have the power to interfere with the rights and property of the minority.

My attention is called by the defendant to an act of April 6, 1908 (*P.L.*, 1908, p. 127), which on its face and by its terms, permits to be done the very thing that is sought to be accomplished in this case. But I am unwilling to accede to this. I must hold that this act is merely the consent of the state that the stockholders may, if they all agree, do the things which are provided for in that act. But if all the stockholders do not agree the act cannot be held to be a portion of the charter of the corporation or an amendment thereto. This is specifically held in *Kean* v. *Johnston*, 9 N.J. Eq. (1 Stock) 417; *Zabriskie* v. *Hackensack Railroad Co.*, 18 N.J. Eq. (3 C. E. Gr.) 178; *Black* v. *United Railroad & Canal Co.*, 24 N.J. Eq. (9 C. E. Gr.) 455; *Mills v. New Jersey Central Railroad Co.*, 41 N.J. Eq. (14 Stew.) 1, and many other cases which have engrafted this doctrine into our law so deeply as to be beyond disturbance.

The motion for the injunction should therefore prevail.

QUESTIONS

1. The D Company is incorporated with a capital stock of $100,000. The directors with the assent of a majority of the stockholders vote to increase the capital stock of the corporation to $200,000. The minority stockholders ask that the corporation be enjoined from so doing. What decision?
2. After the D Company is incorporated, the legislature passes a law, authorizing corporations upon a vote of a majority of their stockholders, to increase their capital stock. The directors and majority stockholders of the D Company are proceeding to take advantage of the law in question. The minority stockholders ask that the corporation be enjoined from so doing. What decision?
3. The directors of the corporation with the assent of a majority of the stockholders vote to increase the capital stock of the corporation. The minority stockholders ask that the corporation be enjoined from doing so. What decision?
4. In what way or ways may the capital of a partnership be increased or decreased?

BURRAL *v.* THE BUSHWICK RAILROAD COMPANY

75 New York Reports 211 (1878)

FOLGER, J. This is an action in which a judgment is asked against a business corporation, that it issue and deliver ten shares of its capital stock to the plaintiff, in accordance with a certificate set forth in the complaint; and pay to him the interest on the value of the same, to-wit; $1,000, from March 28, 1868. It is further asked, that if the corporation fails so to do, the plaintiff may have judgment against it, for $1,000, with interest from the date above named. There is also the prayer for alternative relief.

The defendant has demurred to the complaint, and assigns as cause of demurrer that it does not state facts sufficient to constitute a cause of action.

It is plain that there is no act averred, on which a cause of action arises, for the payment of interest on the sum of $1,000 from March 28, 1868; or on any sum, for any length of time. No averment is found, in the allegations of the complaint, that the shares of stock are of any value. True, in the prayer for judgment, it is said, "upon the value of the same, to-wit, interest on the sum of $1,000"; but that is not an averment of value. True also, in the copy of certificate of stock, set forth in the complaint, there are the character and figures "$1,000"; but they do not make an averment of value; nor is there any averment, that there was a duty or obligation on the part of the defendant to pay interest; nor is any fact averred, from which such duty or obligation can appear, or be inferred. Nor is there any allegation which will sustain an action to recover $1,000 and interest thereon, in case the defendant fails to issue and deliver the stock; for, as has been said, there is no allegation that the stock was at any time of any value. The complaint and its averments are reduced, then, to a cause of action to compel the issuing and delivery of shares of stock. If there be a strict interpretation put upon the phrases in the complaint, viz., "shares of capital stock," "stock herein named," "the stock," "said stock," there is no allegation in the complaint, sufficient to sustain an action to compel the issue and delivery of those shares. The phraseology of the complaint has been used in this particular, with an inexact notion of what is the capital stock of a business corporation, and what are the shares of that stock; though it would seem to be a matter, that at this day should be well understood. A corporation cannot issue and deliver a share

of its capital stock. By joint action of the corporation and the subscriber for its stock, he may become the owner of a given number of shares thereof, but not in such sense as that he may take away those shares out of the common corporate fund. The capital stock is that money or property, which is put into a single corporate fund, by those who by subscription, therefore, become members of the corporate body. That fund becomes the property of the aggregate body only. A share of the capital stock is the right to partake, according to the amount put into the fund, of the surplus profits of the corporation, and ultimately on the dissolution of it, of so much of the fund thus created, as remains unimpaired, and is not liable for debts of the corporation. Such a right may be created as above stated. But such a right, that is, such a share, cannot be issued and delivered by a corporation, continuing in legal existence, and carrying on the business for which it was formed. A demand that it deliver a share of the corporate fund, is to ask of it something which it has not the power to do; and which it will not be compelled to do, by judgment; that is to say, upon the state of facts set up in this complaint. It cannot take from the capital stock, the corporate fund, a part or parts thereof equal in number to the shares or rights therein, claimed by the plaintiff, and hand those parts to him; nor can it, on the facts shown by the complaint, now create the right which those shares represent. Those shares are intangible, and rest in abstract legal contemplation. It has been said, that they are not a species of property that can be transferred by delivery; and that the assent of the owner to part with it must be expressed in writing. (*Davis* v. *Bank of England*, 2 Bing. 393; *Dunn* v. *Com. Bank of Buffalo*, 11 Barb. 580.) It is not needful that we say in this case, that the rule goes to that extent; the saying is cited to point our remark, that the share itself cannot be issued and delivered as a physical act, which is what the prayer for judgment literally taken asks for. What the corporation can do and what in some circumstances it is compellable to do, is to issue and deliver the written evidence of the existence of such shares, and of the ownership of a paper usually called a stock certificate. It is true that the paper set forth in the complaint, as issued by the defendant, declares that Charles Foster is entitled to ten shares of its capital stock, on the surrender of that paper. It is possible, that the paper was not meant to be what we have called a stock certificate, but an evidence that Foster had subscribed for capital stock, and paid in the amount, and that he was

entitled on the surrender of it to a stock certificate. Even then it is inexact, for by the subscription and payment the shares were created, and he became the owner, and entitled to all the rights attainable thereby, and it did not need that he surrender the paper to become so entitled. In rigidity of interpretation then, the complaint shows no state of facts, which entitled either Foster or the plaintiff to the issue and delivery of ten shares of the capital stock of the defendant, which is the judgment asked for. We think, however, that it may be safely held for the purposes of this case, that the paper is the evidence of the right of Charles Foster to ten shares of stock, as we have defined them; and that the averments of the complaint and the prayer for judgment were for the issuing and delivery to the plaintiff of some instrument which will be an evidence and a muniment to him, of an assigned right to those shares. Cases may exist, where the owner of such a right can compel the corporation in whose capital stock it exists, to issue to him that evidence. And we have seen that the cause of action which the facts of this complaint show, if they show any, is only this. To constitute this cause of action, they must show the plaintiff to be, first, the owner of that paper and of the right which it evidences; and, second, that the defendant has unjustly refused to take from him a surrender of the paper, and issue to him a new certificate.

We are of the mind, that in any view in which the case can be looked at that the complaint is too meager in its statement of facts, to show a cause of action in the plaintiff. There are some other considerations, which were urged upon us by the respondent, but they need not be considered.

The judgment for the defendant should be affirmed; and the plaintiff have leave to amend on payment of costs.

QUESTIONS

1. What was the nature of the plaintiff's claim in this case? Upon what theory did he make this claim?
2. What is a share of stock in a corporation? Is it tangible or intangible property? Is it real or personal property?
3. S owns ten shares of stock in a certain corporation. T steals his certificate of stock. What are the rights of S against T?
4. What functions does stock perform in financing a corporate business? Why is ownership in a partnership not divided into shares of stock?
5. What is meant by treasury stock? How can there be such a thing as treasury stock?

6. In some states laws have been passed authorizing the issue of shares of stock without par value. What can be said for and against stock without par value?

NORTHERN TRUST COMPANY *v.* COLUMBIA STRAW-PAPER COMPANY

75 Federal Reporter 936 (1896)

Bill by the Northern Trust Co. and another against the Columbia Straw-Paper Co. and others. On exceptions by one Dickerman and others to the master's report.

Bonds were issued by the Columbia Straw-Paper Co. under a deed of trust made to the Northern Trust Co. and another, and were delivered by the company, together with a large quantity of its stock, to one Stein, in exchange for certain mill plants and cash. Stein sold the bonds at their par value, giving part of the stock to the purchasers as a bonus. Thereafter foreclosure proceedings under the mortgage were instituted, and it was sought by certain stockholders to have certain of the bondholders charged with amounts alleged to be unpaid on the stock received by such bondholders as a bonus.

SHOWALTER, CIR. J. In this case the defendant corporation contracted with Stein, whereby, for certain specified properties, which he caused to be transferred to that company, all or nearly all of the stock of the company was exchanged. Stein afterward delivered or caused to be delivered, it is said, a large portion of this stock to third parties. There was no express agreement by these parties to pay anything to the Columbia Straw-Paper Company in the way of a stock subscription. If the complaint of these defendants be well founded it would simply mean either that the stock should be turned back to Stein or to the company for their benefit, or treated as void. There is no basis in this case for any ruling that the holders of the stock referred to sustained the relation of debtor to the Columbia Straw-Paper Co. for the price of that stock. This is not a case where a stock liability was incurred by certain persons, and afterward gotten rid of in some way without payment. It might be possible to say in this case that certain of the persons to whom Stein delivered the stock were not entitled to it, as against the rights of other persons to whom he delivered other portions of stock, but there is no basis here for declaring an indebtedness by these stockholders to the

Columbia Straw-Paper Co. The Columbia Straw-Paper Co. parted with its capital stock for what was agreed to be the value of that stock. The property which Stein contracted to give, and which he did give, or caused to be given, to the Columbia Straw-Paper Co., was what that company agreed to accept for its stock. In that transaction the Columbia Straw-Paper Co. was in no way wronged. It can have no action to recover on the theory that the stock has not been paid for, nor can any discontented stockholder assert such a right for the Columbia Straw-Paper Co. as against any other stockholder. A quarrel between stockholders concerning the beneficial ownership of stock which has been paid for, is one thing. A controversy between a corporation and a stockholder who has not paid such corporation what is due from him for his stock, is another. The case might be different here if the rights of creditors were involved. I do not say that it would be, but under the decisions of some courts it might be.

It is strongly urged here that the property which the company got for its stock under the Stein contract was not a fair equivalent for the stock, estimating the latter at its par value. As the case turned out and in the light of what happened, this position is doubtless correct; but when the contract was made, and in view of the enterprise then in contemplation, I am not prepared to say that the estimate put upon the property by these parties was so far out of the way. The important point, as the case arises here, is this: Whatever may have been in fact the value of the property turned over to the company for its stock the company agreed to take it for the stock. The persons interested were the stockholders, and there was no dissent on the part of any person concerned from what was then done. Neither any person then holding stock, nor any person who afterward became a stockholder by assignment from one who then held stock, can now make complaint, on behalf of the corporation, as against the fairness of that transaction. This I take to be the settled law on that subject.

Much has been said in the course of the argument about looking through forms and going to the substance of what was done. The corporation sold its stock for a price which everybody interested at that time agreed to, and no harm was done, or wrong committed, either in law or morals. Apart from all the forms adopted by these parties in transacting the business, what the whole thing amounts to is about this: The owners of the mills, we will say, wanted additional capital to carry on their business and desired certain capitalists

to join with them and become interested. These capitalists did so, and furnished $1,000,000, upon the understanding that a certain managing agent should take the legal ownership of the mills, and that the business should be continued and carried on, and that they should have, as against the mill owners, a lien for the repayment of that money upon the mills themselves. After a time the business failed. The persons who furnished the money simply insist upon an enforcement of the lien. The cash was advanced upon this understanding, and there is no offer by the mill owners to return it. I cannot see how a foreclosure of the mortgage could be prevented, on the state of facts here. Even if the circumstances were such as to entitle the mill owners to repudiate the contract, a tender back of the money received by them as part payment for the mills would be a necessary condition. As the case stands, I do not see how a foreclosure can be resisted, or how any set-off, as insisted on, is valid, or can be held good.

I think the exceptions to the master's report should be overruled.

QUESTIONS

1. The P Company issued one hundred shares of its stock to D as a bonus. Subsequently the corporation brought proceedings to have the stock canceled. What decision?
2. A, B, and C, minority stockholders, voted against the issuance of the bonus stock. They brought proceedings to have the stock canceled. What decision?
3. All of the stockholders assent to the issue. S sells his stock to X. P brought proceedings to have the bonus stock canceled. What decision?
4. What is the effect of "watered" or "fictitiously paid up stock" as against creditors of the corporation?
5. In many states it is provided by statute that a private corporation shall not issue stock except for money or property actually received or labor actually performed. For whose protection are such laws passed? What is the effect of stock issued in violation of such provisions?

JACOB SPANGLER *v.* THE INDIANA AND ILLINOIS CENTRAL RAILWAY COMPANY

21 Illinois Reports 275 (1859)

This judgment was pronounced upon a subscription to stock, reciting that, "We, the undersigned, promise to pay to the Indiana and Illinois Central Railway Company, fifty dollars for each share of

capital stock set opposite to our names, in such manner and proportion, and at such times as the directors of said company may order and direct, without any relief whatever from valuation or appraisement laws." The pleadings in the case are stated in the opinion of Mr. JUSTICE BREESE.

On the overruling of the demurrer to the first and second counts of the declaration, the plaintiff below entered a *nolle prosequi* on the common counts, and the court gave him judgment for $1,250—amount of subscription for twenty-five shares of stock.

The defendant below sued out this writ of error, and assigned for errors, the overruling of the demurrer to the first and second counts of the declaration, and the rendering of final judgment for the plaintiff.

BREESE, J. The first objection is, that the declaration is insufficient. It is urged that the declaration should have averred by what law, or laws, the plaintiff existed as a corporation—that the mere statement that the plaintiff was a corporation, is not sufficient.

There is no ground for this objection. There is an averment that the plaintiff at the time, etc., was, and still is, a body corporate and politic, "created under the name and style aforesaid."

By demurring, the defendant admits the fact as averred. If he would deny the existence of such a corporation, he should have put in a plea for that purpose, either in abatement or in bar. *The Society for the Propagation of the Gospel* v. *The Town of Pawlet and Ozias Clark*, 4 Peters R. 480; *McIntire* v. *Preston*, 5 Gilm. R. 58, and cases there cited.

Another objection is, that the declaration does not aver that the board of directors had ordered ten instalments of 10 per cent each, on every share subscribed, amounting to the defendant's full subscription, and had given the defendant notice of it, nor does it aver the time and place when and where the order of assessment was made, and the particular amount of each assessment.

We have decided (*Barret* v. *The Alton & Sangamon Railroad Co.*, 13 Ill. R. 504), that where the power to require payment from subscribers to stock is vested in a board of directors, an action will not lie to recover instalments until the board has directed the call to be made, and due notice of the amount, and the time and place of payment have been given, the subscribers being in no default until these requirements of the charter have been performed.

The undertaking of the defendant is, to pay to the company $50 for each share of capital stock subscribed, in such manner and *propor-*

tion, and at such times as the directors of the company may order and direct. The averment is, that "before bringing the suit, the defendant, by the directors of said body corporate and politic, was duly required and notified to pay the company, as instalments on his subscription of stock, ten assessments of 10 per cent each, amounting in the whole to the sum of $1,250, and being the *amount* in *full* of stock subscribed by the defendant, and the same was personally demanded of him."

In the second count it is averred, that ten instalments of 10 per cent each, amounting to $1,250, due on the stock by defendant, had been called for by the board of directors of the corporation, of which the defendant then and there had, and at all times had, due notice.

The third and last count avers, that the defendant was indebted to the plaintiff in the sum of $1,250, for and in respect of twenty-five shares of stock duly subscribed by him, and which he held in the company, by virtue of divers calls on him, duly made before them by the directors for the time being of the company, and being so indebted, he undertook and promised.

To say nothing of the very loose and inartificial manner in which this declaration was drawn, we think it does not contain the substance of a good declaration in such a case on the contract set forth. The contract must have been understood by both parties to be, that the board of directors would make, periodically, certain assessments on the stock subscribed, of which the subscribers would be duly notified. It could not have been in the contemplation of the defendant, or any subscriber, that he could be called upon to pay the whole amount of his subscription at one time, without notice of previous assessments. This contract, like all others, must be construed according to the intention of the parties as manifested by the language used, and the object contemplated. By this contract, the defendant was to pay his subscription in certain proportions. A call upon him for the whole at once, is not justified by the contract. A demand for the whole might be justified if there had been regular periodical assessments, and the defendant duly notified of them. On failing to pay them, an action would lie for the whole amount. It is indispensable that assessments should have been made by an order of the board of directors, and the subscribers duly notified. *Barret* v. *Alton & Sangamon Railroad Co.*, *ante*. Assessments, as understood in such contracts, mean a rating or fixing of the proportion, by the

board of directors, which every subscriber is to pay of his subscription, when notified of it, and when called on. There is no averment in any one count of this declaration, that any assessment was made, such as was contemplated, of which the defendant had any notice. He cannot be required to pay the whole amount of his subscription until its several proportions have been called for and refused. For this reason the demurrer should have been sustained. It is proper, in such cases, the subscription being the equivalent of an instrument of writing for the payment of money only, that the court, by the clerk, should assess the damages the same as in case of a default, unless leave is asked and given to withdraw the demurrer and plead to issue.

The judgment of the circuit court overruling the demurrer is reversed, and the cause remanded, with leave to the plaintiff to amend the declaration.

Judgment reversed.

QUESTIONS

1. D subscribes for ten shares of stock in the P Company to be paid for thirty days after the issuance of the stock. Thirty days after the issuance of the stock the company brings an action against D for the price of his stock. What decision?
2. S subscribes for stock in the P Company to be paid for as may be required by the directors of the corporation. The company without making any assessment brings an action against D for the price of his stock. What decision?
3. In cases where calls are necessary, by whom must they be made? How must they be made?
4. D purchases stock of the P Company and pays par value in cash for them. The directors of the corporation, to meet a financial emergency, subsequently vote to assess each member of the corporation 10 per cent of the par value of the stock held by him. This is an action by the company against D for the assessment on his stock. What decision?
5. S purchases ten shares of stock in the D Company, which he agrees to pay for in thirty days. In what way can the corporation enforce payment against S after the expiration of thirty days?
6. S, before he has paid for his stock, transfers it to B, who pays value for it but with knowledge that S has not paid for it. What are the rights of the corporation, if any, against B?

2. Devices for Raising Capital

HUDSON REAL ESTATE COMPANY *v.* TOWER

156 Massachusetts Reports 82 (1892)

Contract to recover the amount of a subscription by the defendants, who were copartners, toward the erection of a factory. At the trial in the superior court it appeared that the defendants signed the subscription paper in question. In defense they offered to show that one Harriman, as a solicitor of subscriptions for the capital stock of the corporation, which was to be formed at some time after the subscription was made, asked the defendant Herman C. Tower to subscribe; that, in the course of conversation relative to the matter of subscribing, Tower said that if the subscribers were going to mortgage the property to be bought with the subscriptions his subscription would be merely nominal, but that if they would raise the full amount by subscription, and not mortgage the property, he would subscribe for ten shares, or $500 worth; that Harriman thereupon asked him to subscribe with that understanding, but he declined to do it that day; that, the doctor urging again that he should subscribe upon that understanding, Tower said that he would put down his name if it was understood between them that that was the condition of his subscription, and upon this assurance from Harriman he did subscribe at the time for that amount; that thereafter Harriman reported to the meeting of the subscribers the condition of the defendant's subscription, and that in consequence of that report the meeting voted "that there shall be no mortgage on the property"; that thereafter, and before anything was done by the subscribers, one of their number, then active in their affairs and now president of the corporation, informed Tower, the defendant, that they intended to rescind the vote whereby they voted not to mortgage; that thereupon the defendant Tower told this gentleman that if they so voted he would not pay a penny of his subscription; that this information had come to the ears of a number of the subscribers; that thereafter, namely, upon the thirty-first of August, 1889, they voted "that the vote whereby we voted August 14, 1889, not to place a mortgage on the property be rescinded"; that thereafter the subscribers formed a corporation, and the corporation did on the first day of April, 1890, place a mortgage for $17,000 upon said property in consequence of a legal and proper vote so to do. The defendants further offered to show that nothing had been done by the subscribers

in consequence of said subscriptions before said revocation by defendants.

The court ruled that this would not constitute a defense and direct a verdict for the plaintiff; and the defendants alleged exceptions.

ALLEN, J. At the time when the defendant signed the subscription paper declared on it was not a contract, for want of a contracting party on the other side; but it has now been established that a subscription of this sort becomes a contract with the corporation when the corporation has been organized, and in this way the objection of the want of a proper contracting party is finally avoided, provided everything goes on as contemplated, without any interruption. Until the organization of the corporation, the subscription is a mere proposition or offer, which may be withdrawn, like any other unaccepted offer. Unless the signer is bound upon a contract, he is not bound at all. It is open to him to withdraw. It is not on the ground that there was no sufficient consideration. The seal would do away with any doubt on that score. But it is on the ground that for the time being, and until the corporation is organized, the writing does not take effect as a contract, because the contemplated party to the contract, on the other side, is not yet in existence, and for this reason, there being no contract, the whole undertaking is inchoate and incomplete; and, since there is no contract, the party may withdraw. *Music Hall Co.* v. *Carey*, 116 Mass. 471; *Ives* v. *Sterling*, 6 Metc. 310; *Thompson* v. *Page*, 1 Metc. 565; *Academy* v. *Davis*, 11 Mass. 113; *Phipps* v. *Jones*, 20 Pa. 260.

In the present case there was evidence which would warrant a finding that the defendant thus withdrew before the time came when his subscription would have become a contract. Exceptions sustained.

QUESTIONS

1. D signed the following subscription paper: "For and in consideration of the promises of each other, we and each of us agree to subscribe for stock in the P Company in the amounts set opposite our names." Before the corporation came into existence, D notified the other signers of the list that he did not intend to subscribe for any stock in the corporation. The corporation when organized tenders stock to D and sues him for his refusal to accept it. What decision?
2. In the foregoing case, S, one of the signers of the subscription list, sues D for his refusal to accept the stock tendered to him. What decision?

3. When the corporation comes into existence it refuses to issue stock to D. D sues the corporation for damages. What decision?
4. General incorporating laws usually provide for the opening of subscription books and the taking of preliminary subscriptions as a step in incorporation. D signs such a subscription list agreeing to take ten shares of stock in a certain corporation to be organized. Before the corporation comes into existence he announces his intention not to take the stock subscribed for. The corporation brings this action against him for his refusal to take the stock. What decision?
5. What are the essential requirements of a contract to subscribe for stock in a corporation to be organized?

THRASHER *v* PIKE COUNTY RAILROAD COMPANY

25 Illinois Reports 393 (1861)

This was an action of assumpsit, by the Pike County Railroad Co. against Charles Thrasher, upon an agreement to subscribe for stock in the plaintiff corporation. A jury was waived and a trial had by the court, who found the issues for the plaintiff, and, refusing a motion for a new trial, rendered judgment against the defendant for $3,000 and costs.

BREESE, J. The appellee, who was plaintiff in the court below, urges several reasons justifying a recovery in this case, which it is necessary to notice. The declaration contains a special count, averring, that on the nineteenth of March, 1856, the plaintiffs were a body politic and corporate, with power to construct and operate a railroad within the county of Pike, and authorized by law, as such corporation, to secure subscriptions to the capital stock of the company to the amount of one million of dollars, in shares of one hundred dollars each, and, desiring to ascertain what amount of stock would be subscribed, and not having opened regular subscription books, but intending so to do, agreed with the defendant that they would, in a reasonable time thereafter, open books for the purpose of securing such subscriptions, and that they would permit and allow the defendant, when the books should be opened, to subscribe to the capital stock of the company thirty shares of one hundred dollars each, and upon payment therefor, the defendant should be the owner of thirty shares of the capital stock of the company. It is then averred, that the defendant, in consideration of this promise, undertook and promised the plaintiff that he would subscribe to the stock of this company the sum of three thousand dollars, when the books should

be opened for subscription; that this promise was by a writing, signed by the defendant, and by him delivered to the plaintiff. It is then averred, that on the same day, subscription books to the capital stock of the company were opened, of which the defendant had notice. The breach is, that the defendant neglected and refused to subscribe anything to the capital stock, accompanied by an averment that the subscription, when the books were opened, was due and payable before the commencement of the suit, and although notified thereof, the defendant has refused to pay any part of the sum of three thousand dollars. The common counts are added, in one of which the indebtedness is alleged to be for one hundred shares of the stock of the Pike County Railroad, before that time bargained and sold to the defendant.

This is the cause of action as set forth by the plaintiffs, and it is claimed by them, that they are entitled to recover as damages the par value of the stock, or the amount of calls made from time to time upon it, and which, at the commencement of the suit, amounted to fourteen instalments, of 5 per cent each, making, in all, twenty-one hundred dollars.

This, we do not think, is a fair view of the defendant's liability upon his promise, if one was made to the plaintiff. His undertaking is, to subscribe a certain amount of stock, when the subscription books should be opened. This promise does not make him a stockholder, and, as such, liable to calls. The company has parted with no stock to him, and can only claim as damages, the actual loss sustained by them by his failure, or refusal to subscribe, when he was notified the books were opened for such purpose. The company has the stock which the defendant promised to take, but did not take. His promise is like any other promise, or agreement to purchase any specific article of property. If the property contracted for be retained by the vendor, and there is no delivery to the purchaser, or offer to deliver, the damages must not be measured by the value of the property; for it would not be just, in such cases, that the vendor should retain the property, and recover, also, the value of it from the promisor. Some damage might result from the loss of a bargain, and to such the vendor would be entitled, if the extent could be established. In many cases, they would be merely nominal. On an agreement for the sale and purchase of stocks, and a refusal by the purchaser to take the stocks, the measure of damages, ordinarily, might be the difference between the par value of the stocks and their

market value, or between them and money. As well argued by the appellant, the defendant having violated his promise by failing to subscribe, he has acquired no right to stock; nor could a recovery in this action entitle him to become a stockholder. The company retains its stock, and the defendant his money. A stock certificate of three thousand dollars would represent a value to the company equivalent to so much money, and, in a statement of their liabilities, this would appear against the company as so much held by the stockholders, for which the company was responsible. If there is no actual subscription, the company does not incur this liability.

There being no special damages alleged, or proved, we do not think the plaintiff could recover under this declaration, as they have done, the par value of the stock the defendant promised and agreed to take. A proper count might doubtless be so framed as to justify a full recovery, under sufficient proof.

Judgment reversed.

QUESTIONS

1. What was the issue under consideration in the principal case? How was the issue decided? What rule of law can be deduced from the decision?
2. What is the difference between a contract to subscribe for stock in a corporation and a subscription contract? What practical difference does it make whether a person's undertaking with the corporation is the one or the other?
3. What is the measure of damages which the corporation is entitled to recover when a subscriber refuses to accept stock for which he has contracted to subscribe? What recourse has a corporation when a person refuses to accept stock for which he has subscribed?
4. What are the essential requirements of a contract to subscribe to the stock of an existing corporation?

COLLINGS *v.* ALLEN

90 New Jersey Law Reports 5 (1917)

GUMMERE, C. J. This action was brought by Collings, the trustee of "The Ottomobile Co.," a corporation of New Jersey, adjudicated a bankrupt by the United States District Court, upon a stock subscription signed by the defendant, of which the following is a copy:

Subscription to preferred stock of the Ottomobile Company par value $100 per share. September 25th, 1911. I hereby subscribe to four shares of the par value of $100 per share of the six per cent. preferred stock of the Ottomobile Company, a corporation to be organized under the laws of the

State of New Jersey with an authorized capital of $250,000, six per cent. preferred, and $250,000 common stock, one share of common stock to be given as a bonus with each two shares of preferred. The purpose of the organization is to acquire the automobile interests of the Otto Gas Engine Works of Philadelphia, and the entire assets and good will of the Otto Motor Sales Company of Philadelphia. I agree to pay for such stock as follows: . . . .

and then follows the dates and amounts of the payments.

The case was tried before the court without a jury, and resulted in a finding in favor of the plaintiff for the par value of four shares of the preferred stock, and two shares of the common stock of the bankrupt corporation, with interest upon the same from the date when, according to the finding of the court, the defendant was obligated to take the stock. From the judgment entered on this finding the defendant appeals.

The company of which the plaintiff is the representative was organized under the corporation laws of this state in January, 1912. The principal purposes of its incorporation, as set forth in the certificate filed by it, were to manufacture automobiles, automobile and motor car accessories and supplies of every class and description, including any and all parts of vehicles of all kinds, or any other goods pertaining to the automobile business, or otherwise, which the corporation may determine to manufacture. To buy, sell, and deal in automobiles, automobile and motor car accessories and supplies of every class and description as manufacturers, agents, jobbers, wholesale or retail, on commission or consignment or otherwise, including any part and all parts of vehicles of all kinds, or any other goods pertaining to the automobile business, or otherwise, in which the corporation may determine to deal. To carry on the business of mechanical engineers, and dealers in and manufacturers of plants, motors, engines, and other machinery, implements rolling stock, and hardware of all kinds. To build, construct, and repair railroads, water, gas, and electric works, tunnels, bridges, viaducts, canals, hotels, wharves, piers, or any like work of internal improvement, public use, or utility. To manufacture, purchase, or otherwise acquire goods, merchandise and personal property of every class, and to hold, own, mortgage, sell or otherwise dispose of, trade, deal in and deal with the same. To borrow or raise money without limit as to amount by the issue of, or upon, warrants, bonds, debentures, and other negotiable or transferable instruments, or otherwise.

Other purposes are also specified in the certificate of incorporation; we do not find it necessary, however, to recite them. It is enough to say that the purposes for which the bankrupt corporation was organized are not only far different from, and far more comprehensive, than those for which the proposed company referred to in the defendant's subscription contract was to be organized, but that they do not any of them necessarily embrace either of the two purposes expressed in that contract, namely, the acquisition of the automobile interest of the Otto Gas Engine Works of Philadelphia, and the entire assets and good will of the Otto Motor Car Sales Co. of Philadelphia.

The case was decided below, and is argued here on behalf of the respondent, upon the theory that the appellant by signing the subscription contract became a quasi-stockholder in the proposed company, and that having stood by without protest and permitted the organizers of the now bankrupt corporation to incorporate it for purposes entirely different from those which were originally proposed, he is deemed to have acquiesced in the change, and to be bound by their acts. But, clearly, the position of the appellant was not that of a quasi-stockholder acquiescing in the proposal of his fellow-stockholders to divert his and their moneys to purposes other than those to which they were agreed to be appropriated at the time he signed the subscription. His contract, and that of his fellow-subscribers, was to take specified shares in a New Jersey corporation to be thereafter organized, having a specified name, a specified amount of capital stock, and to be created for the purpose of carrying into effect certain specified objects. The name of the intended corporation was, of course, of secondary importance. That it should be organized under the laws of the state of New Jersey, and so be clothed with all the powers, was of primary importance. So, too, was the amount of the capital stock. But even more important was the purpose to which the moneys of the gentlemen who signed these subscription certificates was to be devoted. They became subscribers upon the express condition that their money should be used for the specific purposes set out in the contracts signed by them, and for such ancillary purposes as were necessary or reasonable. They never agreed to embark their money in any such schemes as are exhibited by the certificate of incorporation by the company of which the plaintiff is the trustee, and, consequently, had no interest in the formation of a company to exploit those schemes. Their acquiescence or non-acquiescence in the organization of such a corporation was entirely immaterial,

so far as the power of the promoters to create it for the purposes specified in this certificate of incorporation was concerned; and their protest against such an action would have been entirely unavailing; for the intended promoters were at perfect liberty to embark their own capital, and the capital of anyone else who desired to join them in floating any scheme which they saw fit to inaugurate, without the let or hindrance of persons who had no interest therein. So, too, they had a right to adopt the name which was proposed for the corporation intended to be organized for the purposes expressed in the subscription contract which the appellant signed; for no right to that name had vested in him and his fellow-subscribers, and could not do so until the corporation in which they had expected to invest their money had actually been formed.

The obligation of the defendant and his fellow-subscribers is expressed within the four corners of the instrument which is the foundation of the present suit. The fact that the promoters of the intended corporation saw fit to abandon the original purposes thereof, and organize a company, the purposes of which were radically different in every respect, could not alter the fundamental contract of Mr. Allen and his associates, and impose upon them an obligation to invest their moneys in the new scheme. We conclude, therefore, that the judgment under review must be reversed.

QUESTIONS

1. The P Company brings an action against D on a stock subscription. D pleads by way of defense that subsequent to his subscription the legislature passed a law authorizing the corporation to consolidate with other corporations and that the P Company has consolidated with the X Company. What decision?
2. D pleads by way of defense that he was induced by fraudulent representations to make the subscription. What decision?
3. D pleads, (*a*) that the corporation has so far failed to comply with the incorporating law that it is only a *de facto* corporation; (*b*) that it has so far failed to comply with the incorporating law that it is not even a *de facto* corporation. What decision?
4. D pleads, (*a*) that the amount of stock required by the statute has not been subscribed; (*b*) that the corporation is not enforcing the subscriptions of other subscribers. What decision?
5. D pleads, (*a*) that the corporation is not proceeding with reasonable diligence in the performance of its corporate purposes; (*b*) that the corporation has abandoned its corporate franchises. What decision?

BUCKSPORT AND BANGOR RAILROAD COMPANY *v.* INHABITANTS OF BREWER

67 Maine Reports 295 (1877)

Case to recover $20,000, subscription to the capital stock of the plaintiff company, alleging a completion of the road and a demand and refusal to pay the subscription, which was in accordance with the following vote of the inhabitants of Brewer at a meeting held December 5, 1871: "That the selectmen be and are hereby authorized and instructed to subscribe $20,000 to the capital stock of the Penobscot and Union River Railroad Co., on the following conditions, viz: The road, when built, shall connect with the European and North American Railroad, and shall be located through the town of Brewer, satisfactory to the selectmen of said town. The town shall not be bound for any further sums than that written by the selectmen acting under the instructions of the town." The name of the plaintiff road was afterward changed but no point was made of that.

The declaration alleged in one count "that the road was located through the town of Brewer, satisfactory to the selectmen" of said town; and in another count "the said road was located wisely, prudently and judiciously, for the interests of said corporation and said town of Brewer, and that the selectmen of said town have hitherto unreasonably and fraudulently refused to approve said location as satisfactory to them."

The principal ground of defense was that the subscription was on conditions, one of which was a condition precedent and had not been complied with.

It was in proof that the first condition, "that the road when built shall connect with the European and North American Railroad" has been complied with; and that the road had been located and built through the town of Brewer; but there was no evidence that the selectmen had expressed satisfaction with the location.

VIRGIN, J. Any city or town, by a two-thirds' vote, may raise and appropriate a sum of money not exceeding 5 per cent on its valuation, "to aid in the construction of railroads in such manner as it deems proper; and for such purpose may make contracts with any person or railroad corporation." R.S., c. 51, section 80.

The plaintiffs contend that the subscription contract declared on was made by the defendants in accordance with the authority conferred by the foregoing statute.

Passing all questions of consideration, acceptance, or whether the subscription contains a promise to pay money, or whether the selectmen exceeded their authority and assuming on all such preliminary matters the view most favorable to the plaintiffs, we come directly to the construction of the subscription in respect to the conditions therein contained.

The subscription, whether of money or stock, is conditional. Such is its express language. The terms are not ambiguous like "provided that" and other similar phrases which do not always import a condition, but the subscription is declared to be made "on the following conditions." The declaration alleges the contract was conditional and avers performance in one count in the very terms of the condition, and undertakes to set out an excuse for neglect of a literal performance in the other. The contract contains two distinct and independent conditions, one pertaining to the connection of the plaintiff's road "when built" with the European and North American Railroad on the other side of the Penobscot River, and the other to the location of the same through the town of Brewer. It matters naught that they may be of different natures; for if the former be a condition subsequent and had been fully performed (as the defendants admit) before the commencement of this action, and the latter be a condition precedent and has not been actually performed, then the action cannot be maintained. *Mill Dam Foundry* v. *Hovey*, 21 Pick. 417, 437; *Ticonic Co.* v. *Lang*, 63 Maine, 480; *Porter* v. *Raymond*, 53 N.H. 519.

The controlling question then is: What is the nature of the condition which requires that the road "shall be located through the town of Brewer, satisfactory to the selectmen of said town"? The word "precedent" is not in it; and neither is it essential that it should be to warrant its interpretation as a condition of that nature. Conditions have no idiom. Whether they be precedent or subsequent is a question purely of intent; and the intention must be determined by considering not only the words of the particular clause, but also the language of the whole contract as well as the nature of the act required, and the subject-matter to which it relates. *Sewall* v. *Wilkins*, 14 Maine, 168; *Robbins* v. *Gleason*, 47 Maine, 259; *Schwoerer* v. *Boylston M. Association*, 99 Mass. 285.

Judged by this rule of common sense, we entertain no doubt that this condition was intended and understood by the parties as a condition precedent, and that it was to be strictly performed before the

defendants could be held liable. The defendants were under no moral or legal obligation to aid the plaintiffs. They simply had the legal authority to do so, if they chose; and for that purpose might make any contract, absolute or conditional, not forbidden by law. Observation demonstrated that the mere fact of a railroad passing through some part of a town did not nceessarily enrich it; while the particular business of a town and its locality might be such as to warrant a generous subscription in aid of a road passing through a particular part. We can readily understand, therefore, why the defendants, in consulting their own material interests, did not blindly make an absolute subscription of money to the stock of the road, but might make a conditional one from which they might reasonably anticipate direct returns by way of increased railroad facilities, provided the new road could be located where it could better accommodate their business, while river navigation is closed, than the old roads across the river, and not otherwise.

By the express terms of this condition, the location in Brewer was to be "satisfactory to the selectmen of said town." This clause is a substantive part of the condition; and the plaintiffs can have no right of action until they have strictly performed it. If the evidence satisfied us that the location was in fact made "wisely, prudently and judiciously for the interests of said corporation and said town of Brewer," as alleged in the second count, while we might conclude therefrom that the plaintiffs' directors had performed their duty thus far, it would not follow that they had performed the condition; for the satisfaction of the selectmen would be wanting. The defendants chose to be governed by the judgment of their board of selectmen instead of that of the plaintiffs' engineers, directors, or of a jury, or any other tribunal. The plaintiffs had the same liberty to accept as the defendants had to propose terms. If they accepted, they must be governed by them as they were made. We cannot change them or substitute others. The authorities requiring strict performance are numerous and pointed.

The evidence of the engineers tending to prove that the route actually selected was the most feasible, cheapest, and best is entirely immaterial. It has no tendency to show performance, neither does it show any legal excuse for non-performance of the condition on which payment by the defendants was made to depend. There is no pretense that performance was impossible at the time the conditional subscription was made, or that it was subsequently rendered

so by the act of God, the law, or by the defendants. Co. Litt. 206*a*. *Blake* v. *Niles*, 13 N.H. 459; *Dermott* v. *Jones*, 2 Wall. 1.

The selectmen took no part in the location which was made. Their opinion was not asked and they did not volunteer any advice. They were a tribunal to decide and not a party whose action or non-action outside of their province could have any influence for or against the defendants. Neither can the mere silence of the defendants be construed as a waiver, since it is consistent with other explanations. *Burlington, etc. Railroad Co.* v. *Boestler*, 15 Iowa, 555.

Plaintiffs nonsuit.

QUESTIONS

1. "The evidence of the engineers tending to prove that the route actually located was the most feasible, cheapest, and best is entirely immaterial." Why?
2. What was the nature of the subscription in this case? Was it made before or after the corporation came into existence? What difference does it make whether it was made before or after incorporation?
3. What is the relation of a person, who conditionally subscribes for stock in a corporation, before the performance of the condition?
4. D conditionally agreed to subscribe for stock in the P Company when organized. The P Company was subsequently organized under a general incorporating law which required that one-half of its authorized capital be subscribed for before it did business. With D's subscription one-half of the authorized capital of the corporation has been subscribed for. What is the effect of D's conditional subscription on the validity of the corporation?

PADUCAH AND MEMPHIS RAILROAD COMPANY *v.* PARKS

86 Tennessee Reports 554 (1888)

LURTON, J. These four suits at law against subscribers to the stock of the Paducah & Memphis Railroad Co. were tried by consent together; and, a jury being waived, the issues of law and fact were submitted to the circuit judge, who has filed his special findings of fact and law as part of the record. There was a judgment in favor of each of the defendants, and an appeal by the plaintiffs.

The contract of subscription upon which the suit was brought was as follows:

July 31st, 1872—We, the subscribers, agree and bind ourselves, our heirs, and legal representatives, to pay to the Paducah & Memphis Railroad Company the sums by us subscribed, to the stock in said railroad company,

upon the following terms and conditions, to wit: One-fourth to be paid when the road is completed to the north or south line of Dyer County; the remainder of the amount subscribed to be paid in four equal installments of four months, as the work progresses through the county: Provided, The company establish a depot on said road within fifteen hundred feet of G. B. Tinsley's corner store, supposed to be the center of Newbern. It is further provided that certificates of stock issue to said subscribers as to other stockholders in said company, upon the payment of their subscription.

The proof shows that there was a gap in the line of a road projected between Paducah, Kentucky, and Memphis, Tennessee, each end of the road being in operation and owned by different companies. The new company was the result of the consolidation of the two old companies, and it undertook the completion of the missing link. Dyer County, of which Newbern is a flourishing village, would be crossed by the finished road.

The assignments of errors are so defective as to raise no question of fact, but the second assignment is sufficient to raise a question of law. We have, therefore, treated the facts as found by the circuit judge as the facts of the case, and will test the soundness of the result he reached by the law applicable. The facts necessary to be stated, as found by His Honor, are as follows:

"That work was commenced on said unfinished part of the road early in 1872, and the Dyer County line was reached on the north in April, 1873, and on the twenty-eighth of that month it ran its train of cars into Trimble Station, in said county. On the fifteenth of May thereafter the company made a call for one-fourth of the subscription, according to contract." This call, together with the second and third calls, was paid by each of the defendants. "The company did work on the road in Dyer County until the last of July or first of August, 1874, at which time it ceased operations and work of all sort. The work principally done in Dyer County was between Dyersburg and Trimble Station, the road was mostly graded, or a great deal of it, from Trimble Station to Newbern, and between Newbern and Dyersburg, and in places bridges were constructed, and cross-ties were collected in one or more places to be placed on the road The road was widened at the place where the depot now stands [in Newbern] as if for side-track, but the company owned no property or land outside of the right of way upon which a depot could be located."

He further held that the proof did not show any further preparations for the establishment of a depot at Newbern than the widening of the grade at that point for side-track purposes. He further found

that, shortly after cessation of work in August, 1874, foreclosure proceedings were instituted by bond creditors and the property and franchises of the corporation sold at public sale, and acquired by the Chesapeake & Ohio Railroad Co.; and this company, being an entirely new and independent organization, has since finished the projected road through Dyer County. That to induce location of depot at Newbern, citizens of that place had been compelled to make a new contract with the successor company, who had assumed none of the contracts or liabilities of the old company. He further found that the old corporation was utterly insolvent at the time it abandoned work, and that at time of trial they had no property, franchises, and practically no existence.

The subscription list was accepted by the Paducah & Memphis Railroad Co., and on the twelfth of September, 1873, after payment of first call by subscribers, was assigned to Childs, Stephens & Co., contractors for work in Dyer County, in part payment for work done and to be done by them. The suit is by these assignees and creditors of the insolvent company. Three of the suits are for the fourth call, which matured in May, 1874, and before work had ceased, and the fourth defendant is sued alone upon the fifth and last call, which did not mature, in point of time, until September, 1874, which was after all effort to complete the road had been abandoned. The question is as to whether defendants are liable for any of the unpaid calls. His Honor, the circuit judge, was of opinion that the construction of the road to the line of the county was a condition precedent to any liability, but that this condition had been met. He was further of opinion that the stipulation requiring the establishment of a depot at Newbern was an independent provision, and not a condition precedent to liability upon the contract of subscription. This latter provision he held required and meant the erection of a depot building, with reasonable facilities for freight and passengers. Upon these facts, and upon the contract as thus construed, the circuit judge held that, although the stipulation as to a depot was not a condition precedent, yet it was a part of the agreement of the corporation which, at some reasonable time, it was bound to carry out, and that as it was now obvious that the utter insolvency of the company, and the sale of its property and franchises, had rendered the performance of this contract impossible, that it therefore followed that the defendants were released from liability upon their stock, both as to calls accruing before and after the abandonment of work upon the road.

In this conclusion we think he erred. If it be conceded that the proviso concerning a depot at Newbern is not a condition precedent, as His Honor does, then it must follow that a breach of an independent covenant will not discharge the other parts of the contract, but that the party damaged by such breach must rely upon his remedy at law for damages, or his remedy in equity, by bill for a specific performance. Such breach will not defeat a right of action upon those parts of the contract not dependent upon it. Before such right of action for a breach of covenant arose the stock list was assigned to creditors of the company, and hence such breach cannot, as against such assignees, be set up to defeat or abate their legal right of recovery. If the construction of a depot had been made a condition precedent to the subscription, or to liability for calls upon stock, then it would devolve upon plaintiff to show performance of such precedent condition; but, on the other hand, if the parties have not chosen to make responsibility depend upon performance of this stipulation, then clearly, defendants must rely upon their independent remedy against the company.

We agree with His Honor that this proviso as to a depot was not a condition precedent, but a mere independent stipulation.

The capital of stock companies consists of their stock subscriptions. This is the basis of credit, and an essential to the organization. This is a trust fund for the benefit of creditors in case of insolvency. Conditional subscriptions to the stock of corporations are unusual, and often operate to defeat subscribers who become such absolutely and upon the faith that all the stock is equally bound to contribute to the hazards of the enterprise. It misleads creditors, and is the fruitful source of litigation and disaster. Tending to the ensnarement of creditors, and contrary to a sound public policy, conditional subscriptions to corporate shares ought not to be encouraged. Their validity, however, is too firmly fixed by a long line of decisions to be now overturned, yet the courts will not strain, where creditors are concerned, to convert independent covenants into conditions precedent. If a subscriber desires to make his liability depend upon the performance of some stipulation by the corporation, it is very easy for him to do so in express terms. In the case now under consideration, it is obvious that the subscribers did not intend to make the building of a depot at Newbern a condition upon which their liability should depend. They expressly provide that one-fourth of their subscription shall fall due when the line of the road is completed to the county line.

Now, this was a condition precedent, but when it was complied with the subscription became absolute, and one-fourth payable at once, and the remainder as the work progressed through the county, in four instalments, four months apart. Now, a depot at Newbern would be folly without a railroad in operation, and every instalment might fall due by lapse of time and continued work within the county, before a depot would be of any practical value. The fact that the first call became payable when the road reached the county line, settles the meaning attached to this stipulation. The acts stipulated to be done are to be done at different times. Hence they are independent of each other, and the remedy of the subscriber for breach of such a stipulation is in damages. *Goldsborough* v. *Orr*, 8 Wheat. 217.

This brings us to a consideration of the question as to whether a suit for the last instalment of these stock subscriptions can now be maintained. The subscription provided for the maturity of the calls subsequent to the first in the following language:

"The remainder of the amount subscribed to be paid in four equal instalments of four months *as the work on the road progresses through the county*." The work was progressing at the time the second, third, and fourth calls were made, and there can be no doubt but that they were rightfully called, and properly demanded. But when the last instalment was called all work had been abandoned, and has never since been resumed. We are of opinion that this last instalment has never matured. The requirement that the calls subsequent to the first should be made in equal instalments "as the work progressed through the county," is a condition precedent to the maturity of each instalment; and the abandonment of the work before it was finished and before, in point of time, the last call could have been made if the work had been carried on in good faith, defeats the action for this instalment. No right to call for or sue upon this instalment exists by reason of the failure of the company to show that the road was finished, or work going on, within the county at the time it was demanded. The objection is made by defendants that these suits cannot be maintained because no tender of stock certificates has been made. This assignment of error is not tenable. This is not a case of the purchase of stock certificates as negotiable securities. The tender in such a case might be necessary to maintain suit for the price. But no tender is necessary to maintain suit upon an ordinary subscription for stock. Morawetz on *Corporations* (2d ed.), sections 61 and 148.

The set-off relied upon by the defendant, Ferrell, in the suit against him was improperly disallowed, the court holding "that there was no proof that defendant filed or relied upon said account as a set-off in that case until it was barred by the statute of limitations." This suit was begun before a magistrate and no formal plea of set-off was necessary there, or upon trial of appeal in circuit court. He did in fact rely upon, and prove, that the company was in fact indebted to him by account for lumber used in construction at the time they assigned his subscription to plaintiffs. This account was not barred at the time suit was instituted against him upon his subscription, and the statute did not thereafter run against his set-off. *Williams* v. *Lenoir*, 8 Bax. 395.

Upon this plea of set-off, the judgment in favor of Ferrell (though placed by His Honor upon another ground) must be affirmed. The judgment in favor of Hoskins must also be affirmed, as he is alone sued upon the last instalment, having paid all the others. The cost of both these cases in the court below, and one-half the costs of this court, will be paid by appellants. The judgments in favor of Parks and Harris must be reversed, and judgment rendered here for the fourth call, with interest and costs in each of the cases against them and one-half the costs of this appeal.

QUESTIONS

1. Can this case be reconciled with the case of *Bucksport & Bangor Railroad Co.* v. *Brewer*, *supra*, page 394?
2. What is the difference between a conditional subscription for stock in a corporation and a subscription on special terms?
3. What is the legal effect of a subscription for stock on special terms?
4. In cases of doubt courts are inclined to construe such contracts as subscriptions on special terms rather than as conditional subscriptions. Why?

BENWELL *v.* CITY OF NEWARK

55 New Jersey Equity Reports 260 (1897)

(Reprinted, *supra*, Vol. II, p. 469)

QUESTIONS

1. What is the essential nature of a bond? Does it resemble more nearly a certificate of stock, a bill of exchange, or a promissory note?
2. In what sense is a bond a device for raising credit? What kind of credit is typically created by bonds?

3. Compare the functions of a bond with the functions of stock in financing a corporation.
4. Under what circumstances and to what extent does a corporation possess the power to raise money by bonds?
5. Can partners issue bonds in financing their business? If they can, why is it that as a general rule they do not do so?

3. Inducements to Investors

a) Transferability of Interest

THE FARMERS' AND MERCHANTS' BANK OF LINEVILLE *v.* WASSON

48 Iowa Reports 336 (1878)

The plaintiff instituted an action at law against H. W. Wilson, and caused an attachment to issue therein, and process of garnishment to be served upon defendant, Wasson. The foundation of the action against Wilson was a promissory note given plaintiff for money borrowed and an account for an overdraft.

The defendant, in the proceedings of garnishment, is sought to be charged on account of certain stock of the bank owned by Wilson, as it is alleged, to which Wasson sets up a claim as the assignee thereof. The cause was finally regarded as a chancery proceeding and tried as such. By the final decree of the court, it was held that the stock, fifty shares, claimed by the defendant, was held by him subject to the attachment and judgment of plaintiff, and judgment for the value thereof, three thousand three hundred and twenty-three dollars and ninety-three cents, was rendered against defendant. He appeals from the decree to this court.

Beck, J. At the time the indebtedness accrued, which is the foundation of the action wherein the process of garnishment was issued, Wilson was a stockholder and director of plaintiff, and Wasson, the defendant, was, and continued to be at the time the process was served upon him, a stockholder of the bank, and president of its board of directors.

Wilson became indebted to the bank for money borrowed, and for overdrafts. Wasson became his surety upon a note to another for another sum borrowed, and was secured by an assignment of the bank stock in question, which, however, was not made as provided for by the by-laws of the bank. It became known that Wilson was in failing circumstances; thereupon defendant obtained from him a

transfer of the fifty shares of stock in controversy, under an arrangement that defendant should pay the debt for which he was surety. The transfer was made by assignment of the receipts given for the payments made upon the stock, and also by the execution of a separate instrument in sufficient form. The transaction was had in the banking house, in the presence of the cashier and a memorandum of the transfer was made upon the proper book of the bank. There is no testimony establishing fraud on the part of the defendant. He became surety for Wilson, so far as the facts appear in the record, in the regular course of business. He practiced no concealment or artifice upon the other officers of the bank in any of the transactions. The object he had in view in taking the stock as security, and in its final purchase was to protect himself as surety of Wilson. His good faith was not impugned by the testimony before us.

The articles of incorporation of plaintiff provide that no transfer of stock is valid, except as between the parties, until it is entered upon the books of the bank; and a by-law further declares that, until approved and accepted by the board of directors, it is invalid. The transfer, as we have stated, was entered upon the proper book of the bank, but the directors refused to approve and accept it. Their refusal was expressed after the transactions between defendant and Wilson, and after the assignment had been executed.

Upon the foregoing facts, we are to determine whether defendant acquired property in the stock of Wilson by the assignment, and whether the transactions are of such a character as to create a liability on his part for the value of the stock.

The articles of incorporation and by-laws declare that no valid transfer of stock can be made until it is entered upon the books of the corporation. This restriction accords with the law of the state. Code, section 1078. But they also contain a further restriction, to the effect that the validity of a transfer depends upon the approval and acceptance of the board of directors of the bank.

These restrictions are intended for the benefit of the corporation, when its rights may be protected thereby, and to prevent the transfer of stock to irresponsible persons, which, if it should occur, would have the effect to impair the credit of the bank. The restriction first mentioned is necessary, in order that the officers of the corporation may know who are stockholders, which is essential in conducting elections of officers, and for other matters. It can never defeat the rights of other parties, and, in all cases, must be regarded as a reason-

able requirement. This, if it were not, as it is, in accord with an express provision of the statute of the state, would demand that it be upheld by the courts.

But the same things are not true of the other restriction. While it may be lawfully enforced to protect rights of the corporation, it cannot, in other cases be exercised without limitation so as to defeat the rights of others. If the corporation has no rights to be protected by its exercise, and other parties would be deprived of their property thereby, it cannot be enforced in such cases. Its enforcement would operate as an infringment upon the property right of others, which the law will not permit. It would, besides, operate as a restraint upon the disposition of property in the stock of the corporation, in the nature of restraint of trade, which the courts will not tolerate. As the restriction is not imposed by express authority of the statute of the state, it cannot, in such cases, be enforced. These conclusions are supported by the following authorities: *Sargent* v. *Franklin Insurance Co.*, 8 Pick., 90; *Quiner* v. *Marblehead Insurance Co.*, 10 Mass., 476; Angell and Ames on *Corporations*, section 567; *United States* v. *Vaughan*, 3 Binn., 394; *Chambersburg Insurance Co.* v. *Smith*, 11 Pa. St., 120; *Chateau Springs Co.* v. *Harris*, 20 Mo., 382.

We will now inquire whether plaintiff had any right to the stock in question, or lien thereon, which it was necessary to protect and enforce by the provision of the by-law forbidding transfer of the stock without the assent of its directors.

It is not claimed that plaintiff held any interest in or right to the stock, under any contract, prior to the proceedings of garnishment. In the absence of a contract, its relation to the stock is that of a stranger. The stock is the exclusive, absolute property of the stockholder, and is held by him free from any claim or right of the corporation, in the absence of contract or provisions of the charter or by-laws creating such claim or right, which have not been shown to exist in this case.

In the absence of contract and provisions of the charter or by-laws, a corporation has no implied lien upon the shares of a stockholder indebted to it, to secure such indebtedness. *Mass. Iron Co.* v. *Hooper*, 7 Cush., 183; *Sargent* v. *Franklin Insurance Co.*, 8 Pick., 90; *Heart* v. *State Bank*, 2 Dev. Eq., 111; Angell and Ames on *Corporations*, sections 355, 569; *Dana* v. *Brown*, 1. J. J. Marsh, 304.

We discover nothing in the case, which in equity gives plaintiff a right to the stock in controversy superior to defendant, in view of the official and fiduciary relation held by defendant as president

of the bank. We have remarked that the transactions whereby defendant became bound as surety of Wilson, and the stock was assigned as security to defendant, and finally transferred in payment of Wilson's debt, exhibit no circumstances which justify the conclusion that defendant practiced any fraud or concealment whereby plaintiff was induced to give credit to Wilson or to refrain from an attempt to seize the stock. Defendant in good faith became surety for Wilson. The case then stood in this way: Plaintiff and defendant were both creditors of Wilson. Defendant was an officer of plaintiff, but was not exclusively charged with the management of plaintiff's business. Indeed it was principally conducted by the cashier, as to matters not controlled by the board of directors. The transfer of the stock to defendant was made with the knowledge of the cashier, who interposed no objection thereto, and no effort was made by him or any other officer of the bank to prevent it. Indeed, it is not shown that any intention or desire was entertained by any officer of the bank to subject in any manner the stock to pay the indebtedness of Wilson. It appears, however, to have been understood by all parties at that time that Wilson was in failing circumstances. No principle of equity or law required defendant to refrain from taking the stock in security or satisfaction of the debts for which he was bound, on the ground that he was an officer of plaintiff.

Wilson had the right fairly to prefer defendant in making payments of his indebtedness, and surely defendant had the right to accept such payment. The fiduciary relations of defendant toward the plaintiff, which, it may be conceded, demanded *uberrima fides* in the discharge of his duties, did not require him to sacrifice his own rights under contracts, or appropriate payments voluntarily made upon claims in his favor to indebtedness held by the bank.

The authorities cited by plaintiff's counsel to support their position, that defendant in equity could not accept payment from Wilson, and thereby defeat the right of the bank, are not applicable to the case made by the testimony. The rules recognized by them are applicable to purchases of property or other transactions whereby those discharging duties under fiduciary relations realize profits or benefits from the use of a trust fund. Equity holds the beneficiaries entitled to receive such profits or benefits.

The transfer of the stock to defendant did not conform to the requirements of the regulations adopted by the corporation upon

that subject. We have seen that the by-law requiring the transfer to have the assent and approval of the directors cannot be enforced to defeat defendant's rights. Failure to follow other requirements of the charter or by-laws would not, in the absence of any rights to or lien upon the stock held by plaintiff, defeat defendant's right to hold the stock, and enforce a transfer in proper form. As between Wilson and defendant the transfer passed an equitable interest, at least, in the stock. As against Wilson this equity, it cannot be doubted, may be enforced, and a legal transfer based thereon may be obtained by defendant. The bank, as we have seen, having no lien upon or interest in the stock, can offer no obstacle to the enforcement of defendant's equitable rights. Defendant, therefore, must be regarded in equity as the owner of the stock. This doctrine, we think, is the undoubted rule of the authorities. See Angell and Ames on *Corporations*, sections 354, 355, 356, and 575, and cases cited.

The foregoing discussion disposes of all questions arising in the case. The decree of the circuit court is reversed, and the cause is remanded for a decree in harmony with the decision.

Reversed.

QUESTIONS

1. What is the nature of a share of stock in a corporation? What functions does it perform? What degree of transferability does it need to perform its functions well?
2. S, owner of ten shares of stock evidenced by a certificate of stock, sold his interest in the corporation to B without indorsing and delivering to B his certificate of stock. What is the legal effect of the transaction?
3. What is the purpose of a provision that a stock transfer shall not be complete until entered upon the books of the corporation? Is it valid?
4. What is the purpose of a provision that the transfer shall not be complete until approved by the directors of the corporation? Is it valid?
5. How is a complete transfer of stock ordinarily accomplished?
6. How can a partner transfer his interest in the partnership? What is the legal effect of such transfer?

WEST NASHVILLE PLANING-MILL COMPANY *v.* NASHVILLE SAVINGS BANK

86 Tennessee Reports 252 (1888)

LURTON, J. The complainant, a manufacturing corporation created under the provisions of the General Incorporation Act of 1875, sues the defendant upon a stock call duly made for twenty-five

shares of stock now standing upon the stock books of complainant in the name of Julius Sax, president. This stock was originally subscribed by one J. B. Tucker, who paid one-half of the subscription price, but to whom was issued stock certificates, one of which was in the following words:

Shares $100 each.

West Nashville Planing-Mill and Lumber Company, Nashville, Tenn:

This is to certify that J. B. Tucker is entitled to thirty-five shares, of one hundred dollars each, in the capital stock of the West Nashville Mill and Lumber Company of Nashville, subject to all the conditions and stipulations contained in their articles of incorporation; transferable by him or his attorney only on surrender of this certificate.

In testimony whereof, the President and Secretary of said company have hereunto subscribed their names.

R. F. Woodard, *President.*
T. O. Treanor, *Secretary.*

The defendant bank, without notice that the stock was not in fact paid up, and in good faith, made a loan to Tucker, and took his stock certificates as collateral security, with usual power of attorney to transfer same. Subsequently the bank surrendered original certificates and caused new certificates to issue to itself identical in form with the original. Under these facts defendant must be treated as if an innocent purchaser for value, without actual notice of the fact that the stock was subject to future calls for unpaid balance of subscription price. A number of defenses to this suit have been very ably and earnestly pressed by the solicitor for the bank, but in the view we take of the case we need only determine one of them. The general rule concerning the effect of the transfer of shares in a corporation is that such transfer operates as a novation of the contract of membership. The transferer ceases to be a shareholder, and the transferee becomes one. The first is ordinarily relieved from all further liability to contribute capital, and loses all right to participate in the further profit or management; the transferee takes the place of the retiring member, and by implication assumes all the obligations which rested upon the former as a member of the company, and ordinarily becomes liable for calls to the same extent as the former owner before the transfer was made. Assuming the burdens, he becomes likewise entitled to all the benefits attaching to ownership of the shares. In the absence of charter provisions or statutory regulations, this general rule is almost universally recognized.

Morawetz on *Corporations* (2d ed.), section 159 and authorities cited.

It is clearly so settled in this state. *Jackson* v. *Sligo*, 1 Lea, 213; *Moses* v. *Ocoee Bank*, 1 Lea, 398.

Stockholders become such in several ways—either by original subscription, or by assignment of proper holders, or by direct purchase from the company. It is not at all essential that at the time there is an original subscription there shall be an express promise to pay the subscription price. Oftener than otherwise there is none, the subscription being a simple agreement to take so many shares of stock. By necessary implication there arises from such a subscription a promise to pay the par value of such stock, upon which an action of assumpsit lies. *E. T. & R. R.* v. *Gammon*, 5 Sneed, 570.

The Massachusetts and Maine cases, holding an express promise necessary, are exceptional, and are based chiefly upon the charter remedy of a sale of the stock being regarded as exclusive in the absence of an express agreement to pay. The liability of the transferee of unpaid stock is expressly put upon the same ground of an agreement by implication from the acceptance of a transfer of unpaid stock, thus coming into privity with the corporation, and by implication rendering himself liable to action by the corporation for subsequent calls for unpaid balance of subscription price. Morawetz on *Corporations* (2d ed.), 159; *Webster* v. *Upton*, 91 U.S., 65.

The Pennsylvania cases, holding that the transferee is not liable without express agreement, are exceptional, and do not commend themselves to us by their reasoning.

The General Incorporation Act of 1875, under which complainant holds its charter, contains nothing which affects the question of the ordinary liability of a transferee to the corporation. Section 5 of that act only provides for the continued liability of the transferer in the case mentioned.

As we have seen, the rule which makes a transferee liable for unpaid calls is based upon the implied agreement arising where one takes shares subject to calls, and causes them to be transferred to himself. But where the purchaser of such shares buys them as *paid-up* shares, and without notice that in fact they are not paid up, then no implication arises of an agreement to pay anything to the corporation for such shares. In such case there are no facts from which to imply an agreement. The representation made by the corporation, either upon the face of the stock certificate or by its officers, that the shares are paid up will, as between the corporation and such trans-

feree, prevent any contract by implication. Morawetz on *Corporations*, section 161; Cook on *Stocks*, sections 50, 257, and 418.

The question arising upon the certificates in this case is not so easy of solution, inasmuch as there is no express declaration on the face of it that the shares are non-assessable or paid up. In such a case the question is a perplexing one as to whether the purchaser of such shares is bound, at his peril, to make inquiry, or whether he is not protected by the want of notice.

This certificate is in the usual commercial form of certificates issued for shares fully paid up. There is no intimation upon its face that it is not what it appears to be. The corporation, in putting such shares upon the market, has put it in the power of the subscriber to sell the same to persons innocent of the true fact. Under such circumstances, ought the corporation to be suffered to demand from an innocent transferee, for value, the balance of the subscription price? Certificates of stock are quasi-negotiable securities. The vast number of such shares daily sold upon the market have led the courts to aid their commercial and negotiable character in favor of purchasers without notice of secret liens. Thus an assignment of certificate of stock is held to pass the legal title to such shares to the assignee, even without transfer upon stock book or other notice to the corporation. *Cornick* v. *Richards*, 3 Lea, 1.

Again, this court held that if the pledgee of a stock certificate, with blank power of attorney, subpledged such certificate for money loaned, the subpledgee, if ignorant of the title of his pledgor, will hold the certificate as against the true owner. *Cherry* v. *Frost*, 7 Lea, 1.

In view of the important character assumed by shares of stock in both the speculative and investment markets, and in view of the readiness with which corporations can guard themselves, as well as purchasers of such shares, by issuing only fully paid shares, or by expressing upon the face of such as are not paid up the fact that they are subject to call for unpaid subscription price, we hold, in the interest of the negotiability of such shares and of what we deem a true public policy, that a bona fide purchaser of a certificate of stock, for value, and without notice, either from the face of the certificate or otherwise, that the subscription price has not been paid, will be protected as between himself and the corporation negligently issuing such shares. This rule we regard as most in accord with the usages, customs, and demands of commerce, and as calculated to prevent the assumption of unsuspected liabilities on the one hand, and the illegiti-

mate use of unpaid shares of stock on the other. Cook on *Stocks*, sections 50 and 257.

The rule is in analogy with the principles governing contracts, and there can be no implied contract to pay unpaid calls where the purchaser buys what he is entitled to believe are paid-up shares.

The decree of the chancellor is affirmed.

QUESTIONS

1. D transfers his stock in a certain corporation to B. The corporation refuses to issue a new certificate of stock to B. What are the rights of B, if any, against the corporation?
2. The corporation declares dividends on January 1. D sells his stock to B on January 15. Who is entitled to the dividends on the stock in question?
3. On January 1, the corporation makes a call for 20 per cent of the par value of the stock. On January 15, D sells his stock to B. On February 1, the corporation makes a second call on the stock. Who is liable for these calls on the stock in question?
4. The law of the state under which the corporation was organized provides that stockholders, in addition to their liability for the par value of their stock, shall be liable to creditors in an amount equal to the par value of the stock. D transfers his stock to B. What are the rights of creditors, if any, against D? against B?
5. The corporation in excess of its powers purchases a tract of land. Subsequently D sells his stock to B. B brings an action to have the *ultra vires* transaction set aside. What decision?

EAST BIRMINGHAM LAND COMPANY *v.* DENNIS

85 Alabama Reports 585 (1888)

(Reprinted, *supra*, Vol. II, p. 465)

QUESTIONS

1. What was the issue involved in this case? How was the issue decided? What rule of law can be deduced from the decision?
2. S, owner of ten shares of stock in the P Company, indorses his certificate of stock in blank and loses it. T finds and sells it to B, a bona fide purchaser. What are S's rights against B?
3. S delivers the certificate of stock, indorsed in blank, to A and directs him to pledge it with B as security for a loan. A sells it as his own to B. What are S's rights against B?
4. In Question 1, B surrenders the certificate of stock to the corporation and receives in exchange for it a new certificate of stock. What are the rights of S and B with respect to the stock?

5. B sells the new certificate to C, a bona fide purchaser. What are the rights of the parties with respect to the stock?
6. Does a certificate of stock possess as high a degree of transferability as a bill of exchange? To perform its functions does it need to possess as high a degree of transferability as a bill of exchange?

EDELSTEIN *v.* SCHULER AND COMPANY

Law Reports 2 King's Bench Division 144 (1902)

(Reprinted, *supra*, Vol. II, p. 472)

QUESTIONS

1. What was the issue involved in this case? How was the issue decided? What rule of law can be deduced from the decision?
2. What degree of transferability does a bond possess?
3. Does the ordinary bond come within the provisions of the Negotiable Instruments Act?
4. H is the holder of a bond payable to the "registered holder." Is it transferable by indorsement and delivery? If not, how is it transferable?
5. The M Company issues a bond payable to the "order of the registered holder." Is this instrument transferable by indorsement and delivery?

b) Participation in Management

THOMPSON *v.* BLAISDELL

93 New Jersey Law Reports 31 (1919)

SWAYZE, J. This is a summary investigation of a corporate election under section 42 of the Corporation Act. The controversy turns on the right to vote two hundred and forty-two shares standing in the name of Albert Kumpel. This right was denied by the inspectors at the election. These shares, if voted, would have changed the result. Theodore Kumpel sought to vote them by virtue of a proxy from Albert. It is not denied that Albert appeared as owner on the books of the company on the day of the election, or that the proxy was in proper form and properly executed. On the face of the papers Theodore was entitled to vote the shares. Under the rule of *Downing* v. *Potts*, 23 N.J.L. 66, and the *St. Lawrence Steamboat Co. Case* 44 Id. 529, the action of the inspectors was erroneous, and the election ought to be set aside or the contesting party put in office. The incumbents rely not on any defect in the record title to the stock or in the proxy, but on a situation disclosed by the facts of

the case as established by evidence *aliunde* and not legally before the inspectors of election. These facts are supposed to require the court to establish the right of the incumbents, pursuant to the injunction of section 42 of the act requiring us to give such relief in the premises as right and justice may require.

The facts are that Albert gave the proxy to Theodore on March 24; that afterward, on April 5, Theodore determined to buy the stock at Albert's request and sent Albert a check for the purchase price. Albert signed a transfer, but Theodore did not register the transfer on the books of the company and the stock still stood in Albert's name on May 13, the day of the election. His reason seems to have been that there was a real or supposed right of pre-emption in the company and he desired to avoid any question as to his title to the stock. It is now argued that the proxy was revoked by the sale to Theodore. Stock is often sold while the transfer books are closed, and it would be a manifest injustice to deprive the vendee of the right to vote, which the act is at some pains to secure him, because he has bought within twenty days next preceding election. Section 36 secures each stockholder the right to vote; it does not disfranchise stock which has been sold within twenty days next preceding the election, but only stock which has been transferred *on the books*. Whether the vendee shall be disfranchised is thus made to depend on his own action or inaction. There is nothing in the language to prevent the vendee, by agreement with the vendor, from securing his right to vote by means of a proxy, although not yet registered as a stockholder. The law was long ago established in New York under similar legislation (*People* v. *Tibbits*, 4 Cow. 385), and has more recently been followed *In Re Argus Co.*, 138 N.Y. 557, 579; 43 N.E. Rep. 388. This rule is in harmony with the principle that requires a trustee in case of a dry trust to give a proxy. *American National Bank* v. *Oriental Mills*, 17 R.I. 551; 23 Atl. Rep. 795. Granting that the sale is a technical revocation of the proxy, it would be idle to require the former owner, now become a trustee of a dry trust for the unregistered vendee, to execute a new proxy where both he and his vendee are content with the control of the voting power given by the title shown on the transfer books accompanied by the proxy. The rule is also in harmony with the policy that entitles every stockholder to the benefit of the vote of every other stockholder and entrusts the voting power to the beneficial owner. A distinction is made by the statute, as Mr. JUSTICE DEPUE pointed out in the St. Lawrence Steamboat Co. case, between the

qualification for voting at the stockholders' meeting—registration on the transfer books only, and the qualification of director—bona fide ownership of stock.

A man may vote, although not a bona fide owner of stock, and may vote by proxy. We see no reason why a vendor who is still registered as a stockholder may not vote by proxy. The case is still stronger where the proxy is held by the vendee.

We are not now dealing with technical legal rights. Those rights at the time of the election were with Theodore Kumpel. The inspectors could not go outside the face of the papers. We are dealing with a question of right and justice under the mandate of the statute, and the answer to the question depends on the beneficial title to the stock. If there was no right of pre-emption in the corporation Theodore Kumpel was the beneficial owner of the stock, as well as the person entitled to vote it on the fact of the books and the proxy. If there was a right of pre-emption, the legal title was still in Albert, the sale had never been perfected, and the proxy had not been revoked. As the right of pre-emption seems to be a disputed question, we think we ought not now establish the title of the contestants and oust the incumbents. Instead of that we order a new election which, if necessary, may be conducted under the direction of a Supreme Court commissioner.

We have passed by the suggestion that there was unanimous consent that the two hundred and forty-two shares should be disfranchised. The evidence is not persuasive to that effect. We cannot, for instance, assume that the seventy-eight shareholders represented by proxy assented to the disfranchisement, and the minutes show only an assent by "both sides," which is far from showing unanimous consent even of stockholders present, since some may not have taken sides.

QUESTIONS

1. S, owner of stock in the M Company, sells his stock to B and delivers to him a certificate of stock properly indorsed. Who is entitled to vote this stock before a transfer is made on the books of the corporation?
2. S pledges his stock to C as security for a debt. Who is entitled to vote the stock?
3. Do bondholders of a corporation have the right to vote? Do holders of preferred stock have the right to vote?
4. Under what circumstances is the holder of stock entitled to vote by proxy?

5. What is meant by cumulative voting? What is the purpose of permitting a stockholder to cumulate his votes?
6. The M Company, having a capital stock of $75,000, divided into shares of the par value of $100, under authority of law increases its capital stock to $100,000. S, owner of a hundred shares of stock in the corporation, demands the right to subscribe for stock in the new issue. The corporation ignores his demand. What are S's rights, if any, against the corporation?
7. Does a partner have a right in his firm comparable to the right of a stockholder to vote at stockholders' meetings? If so, does the right depend upon the *quantum* of his interest in the firm?

SMITH *v.* SAN FRANCISCO AND NORTHERN PACIFIC RAILWAY COMPANY

115 California Reports 584 (1897)

Smith, the plaintiff herein, Foster and Markham purchased stock in the Northern San Francisco and Pacific Railway Company, the defendant, under an agreement that the stock should be voted as a unit for a period of five years. During the five-year period, in view of an approaching meeting for the election of directors, a vote was taken between the three as to how the stock should be voted. At the meeting, Smith, dissatisfied with the arrangement in question, attempted to vote the stock standing in his own name. Foster offered to vote all the stock according to their ballot. The vote of Foster was accepted. This was an action by Smith brought under the Code to determine the validity of the election. He alleged that if his vote had been accepted the election would have been otherwise. The trial court rendered judgment in favor of the plaintiff.

HARRISON, J. The instrument executed between the parties must be held to be a proxy, and to authorize the vote of 42,000 shares of the stock to be cast in accordance with the determination of the majority of the parties thereto; and, if it was made upon a consideration sufficient to bind the parties to its enforcement, it must be regarded as still operative. One of the inducements for the purchase of the stock, and under which the parties entered into the agreement, was that the shares should be voted in one body, and held for five years as a unit. It is immaterial that the voting agreement was not reduced to writing and executed until after the bid had been made for the stock. It was so executed before the parties thereto had completed the purchase, and become the owners of the stock by

paying the purchase price. Nor is the validity of the agreement or the effect of its terms different by reason of different certificates having been issued in the names of the several parties to the transaction, rather than in the name of one of them. The agreement between them was with reference to the 42,000 shares of stock, that it should be voted as a unit, and the purpose of the agreement was the economical management of the road, and to prevent irresponsible persons from getting control.

It was within the powers of the parties to contract in reference to this property as fully as with regard to any other property. They were at liberty to make as a condition of their purchase that its management should be held by either of them, or by a majority of the three, and the terms of the agreement for such purchase could not be repudiated by either after the purchase had been made. It may be assumed that neither of the parties would have entered into the transaction or agreed upon the purchase of the stock except upon these conditions and it must be held that each contributed his money to the purchase of the stock upon the promise made to him by the others. There was thus a sufficient consideration for the agreement granting the right to vote the stock. It was in the nature of a power coupled with an interest, and, being given for a valuable consideration, could not be revoked at the pleasure of either. *Hey* v. *Dolphin*, 92 Hun, 230, 36 N.Y. Supp. 627.

Although the court, in excluding the evidence, assumed that the instrument was valid, counsel for respondents have presented an argument in support of their further objection thereto that the instrument is invalid by reason of being against public policy; and it therefore becomes necessary to consider this objection, inasmuch as the action of the court, rather than its reason for so acting, is to be reviewed; for, if the instrument is invalid, the refusal of the court to allow any effect to be gained from its exercises was proper.

"Public policy" is a term of vague and uncertain meaning, which it pertains to the law-making power to define, and courts are apt to encroach upon the domain of that branch of the government if they characterize a transaction as invalid, because it is contrary to public policy, unless the transaction contravenes some positive statute or some well-established rule of law. Sir George Jessel as master of the rolls, said in *Besant* v. *Wood*, 12 Ch. Div. 505, that public policy is "to a great extent a matter of individual opinion, because what one man or one judge might think against public policy another

might think altogether excellent public policy." And in another case (*Registering Co.* v. *Simpson*, L.R. 19 Eq. 465), the same jurist said: "If there is one thing which, more than another, public policy requires, it is that men of full age and competent understanding shall have the utmost liberty of contracting and that their contracts, when entered into freely and voluntarily, shall be held sacred, and shall be enforced by courts of justice."

It is not in violation of any rule or principle of law for stockholders who own a majority of the stock in a corporation to cause its affairs to be managed in such a way as they may think to have been calculated to further the ends of the corporation, and for this purpose to appoint one or more proxies, who shall vote in such a way as will carry out their plan. Nor is it against public policy for two or more stockholders to agree upon a course of corporate action, or upon the officers whom they will elect; and they may do this either by themselves or through their proxies, or they may unite in their appointment of a single proxy to effect their purpose. Any plan of procedure they may agree upon implies a previous comparison of views, and there is nothing illegal in an agreement to be bound by the will of the majority as to the means by which the result shall be reached. If they are in accord as to the ultimate purpose, it is but reasonable that the will of the majority should prevail as the mode by which it may be accomplished. It would not be an illegal agreement if articles of partnership should provide that stock in a corporation owned by the partnership, though standing in the individual names of the partners, should be voted by one of its members; and it is no more against public policy for such an agreement to be entered into between stockholders whose interests in the stock are separate than where their interests are joint.

Viewed from considerations of public policy only, it is immaterial whether such an agreement is made by the members of an existing partnership, which owns the shares, or in pursuance of an agreement by two or more persons to form a partnership for their purchase, or to purchase them for their joint account, or as one of the terms of an agreement for their purchase by persons who contemplate no relation to each other, further than that of owning stock in the same corporation. Such agreement would in any case be outside the corporation, and disconnected with the interest of every other stockholder and in either case the same rules would control. Whether such an agreement is illegal, so that any action or vote under it can be set aside, or is of such a character that it will not be enforced, will

depend upon the object with which it is made, or the acts which are done under it, and will be governed by other rules of law.

In cases of "voting trusts," where the owners of stock transfer the shares to a trustee with authority to vote at elections according to the direction of a majority of those holding trust certificates, and the only consideration for such transfer and agreement is the mutual promises of the several stockholders it has been held that any stockholder may revoke his agreement and withdraw his stock at will; and it is also held that stockholders who become such after an agreement of this nature is entered into are not bound by its terms, but will hold their shares freed from the limitations of the agreement.

The agreement in question cannot be regarded as illegal by reason of being in restraint of trade. The rule invalidating contracts in restraint of trade does not include every contract of an individual by which his right to dispose of his property is limited or restrained. Section 1673, Civ. Code, makes void every contract by which one is restrained from "exercising a lawful profession, trade, or business," except in certain instances. But this is far different from a contract limiting his right to dispose of a particular piece of property except upon certain conditions. As the owner of property has the right to withhold it from sale, he can also, at the time of its sale impose conditions upon its use without violating any rule of public policy; and there is nothing inconsistent with public policy for two or more persons who contemplate purchasing certain property to agree with each other, as a condition of the purchase, that neither will dispose of his share within a limited period, or for less than a fixed sum, or except upon certain limitations. They have the same right to contract with reference to the terms under which they will hold or dispose of the property after it shall have been purchased, as they have to agree upon any other terms upon which the purchase shall be made; and they no more violate a rule of public policy in making such agreement a consideration of their purchase than would two or more partners, who should purchase property for partnership purposes, and agree that it should not be disposed of unless their vendee would assent to certain conditions regarding its use. Those terms enter into and form a part of the consideration for the agreement or purchase, and are as binding and enforceable as any other terms of the agreement. *Trust Co.* v. *Abbott*, 162 Mass. 148, 38 N.E. 432, 27 L.R.A. 271; *Hodge* v. *Sloan*, 107, N.Y. 244, 17 N.E. 335, 1 Am. St. Rep. 816; *Williams* v.

Montgomery, 148 N.Y., 519, 43 N.E. 57; *Matthews* v. *Associated Press* 136 N.Y. 333, 32 N.E. 981, 32 Am. St. Rep. 741.

The contract in *Fisher* v. *Bush*, 35 Hun (N.Y.) 641, was held to be invalid for want of any other consideration than the mutual promise of the parties; but it was said in that case:

> If these parties and their associates were the promoters of this corporation, then, doubtless they could have entered into a valid agreement regulating a sale of the same, and requiring the owners to hold them from market for a reasonable and definite period of time, and thus forbidding a sale by either of his interest to one against whom his associates might have a reasonable objection. *Moffatt* v. *Farquhar*, 7 Ch. Div. 591; reported in 23 Moak Eng. R. 731. A stipulation of that character would not be illegal, as against public policy, as it would be simply a provision, assented to by all, that the new-comer into the business transaction should be with the approval of the other joint owners.

Neither is it illegal or against public policy to separate the voting power of the stock from its ownership. The statute authorizes the stockholder to vote by proxy, and it was held in *People's Home Savings Bank* v. *Superior Court of City and County of San Francisco*, 104 Cal. 649, 38 Pac. 452, 29 L.R.A. 844, 13 Am. St. Rep. 147, that a by-law restricting the selection of proxies to stockholders was invalid, that the statute places no limitation upon the right of selection and that a stockholder may appoint as his proxy one who is an entire stranger to the corporation. The right to appear by proxy implies, of itself, that the voting power may be separated from the ownership of the stock; and, unless the authority of the proxy is limited by the terms of his appointment, he is necessarily required to use his own discretion in any vote that he gives. Being the agent of the stockholder, he is required to exercise this discretion in behalf of his principal; but he is at liberty to use his own discretion as to the means by which his principal's interest will be best subserved. The cases in which it has been said that the stockholder could not divest himself of the voting power of his stock, were cases which involved either the sufficiency of the agreement by which the voting power was transferred, or the validity of the purpose for which the power was to be exercised. The proxy must exercise a discretion of the same nature as that which the stockholder is authorized to exercise, and an authority to do otherwise would be invalid; but the authority to exercise a discretion differs from an authority to perform a particular act.

Under an appointment without words of limitation, the proxy may act against the interests of the stockholder, or even against the interests of the corporation and the corporation, as well as the stockholder, will be bound by his act as fully as if the stockholder had acted in person; while, if the authority had been directed in terms to that act, it might have been invalid. The distinction is that between an unlawful exercise of a lawful power and the attempt to authorize the exercise of an unlawful power. The question has been presented in cases of voting trusts, but an examination of these cases will show that the question has arisen either when the authority was expressly given to carry out some illegal purpose, or, when having been given without any consideration though purporting to be for a definite term, subsequent owners of the stock have sought to revoke it before the expiration of the term. *Shepaug Voting-Trust Cases*, 60 Conn. 553, 24 Atl. 32, sometimes reported under the name of *Bostwick* v. *Chapman; White* v. *Tire Co.*, 52 N.J. Eq. 178, 28 Atl. 75.

We have been cited to no instance where the purpose of a proxy given upon a sufficient consideration was lawful, and the person by whom the proxy was created continued to be the owner of the stock, in which the agreement has been held invalid. The stockholder cannot separate the voting power from his stock by selling his right to vote for a consideration personal to himself alone, any more than he could agree, for the same consideration, to cast the vote himself; and an agreement with others to appoint a proxy upon the same considerations would be equally invalid. In *Cone* v. *Russell*, 48 N.J. Eq., 208, 21 Atl. 847, an agreement by the purchaser of stock to give to other stockholders his irrevocable proxy, for the purpose of securing and maintaining the control of the company, was held invalid, for the reason that it was one of the terms of the agreement that the directors to be elected under its provisions should employ the one giving the proxy at a fixed salary during its existence. Such an agreement was held to operate as an inducement to elect directors who would not act disinterestedly for the benefit of all the stockholders, but rather to promote the interest of the parties to the agreement alone, and was therefore void, as being against public policy. The court, however, said: "This conclusion does not reach so far as to necessarily forbid all pooling or combining of stock, where the object is to carry out a particular policy with the view to promote the best interests of all the stockholders."

It was upon this principle that the agreements in *Hafer* v. *New York etc. Railway Co.*, 14 Wkly. Law Bull. (Ohio) 68, *Guernsey* v. *Cook*, 120 Mass. 501, and *Fennessy* v. *Ross*, 5 App. Div. 342, 39 N.Y. Supp. 323, were held invalid. The same principle was declared in *Gage* v. *Fisher*, 5 N.D. 297, 65 N.W. 809, 31 L.R.A. 557. In *Railroad Co.* v. *Nicholas*, 98 Ala. 92, 12 South. 723, the court held that there was nothing illegal or contrary to public policy in separating the voting power of the stock from its ownership, saying: "Where a proxy is duly constituted, and the power of the appointment is without limitation, the vote cast by the proxy binds the stockholders, whether exercised in behalf of his interest or not, to the same extent as if the vote had been cast by the stockholder in person. The invalidity of acts of this character by a proxy rightly understood, is not made to rest upon the ground that there has been separation of the voting power from the stockholders, but because of the unlawful purpose for which the proxy was appointed, or the unlawful end attempted to be effected by the exercise of the voting power."

The judgment and order denying a new trial are reversed.

QUESTIONS

1. What test did the court announce in this case for determining whether or not the arrangement in question was legal?
2. A, B, and C, owners of a majority of the stock of the X Company, enter into an agreement by which A is to vote the stock as a unit for a period of five years. The purpose of the arrangement is to secure unity of control so that the corporation can make profits which it had theretofore been unable to do. Discuss the validity of the arrangement.
3. In the foregoing case, the arrangement gives A the right to vote the stock for a period of twenty-five years. Discuss the validity of the arrangement.
4. The purpose of the agreement is to secure control of the corporation and gradually go out of business contrary to the will of the minority. Discuss the validity of the agreement.
5. A, B, and C, under a mutual agreement, transfer their stock to T, a representative of the creditors of the corporation, for a period of five years. T is to hold the stock in trust for the stockholders and vote it in the interest of an economical administration of the corporation. Is there any way for A to get back his stock before the end of five years?

c) Participation in Profits

HUNTER *v.* ROBERTS, THROP AND COMPANY

83 Michigan Reports 63 (1890)

CHAMPLIN, C. J. Roberts, Throp & Co. is a manufacturing corporation organized under the laws of the state of Michigan, and engaged in the manufacture of threshing-machines and other agricultural implements. Complainant's intestate was a stockholder in the corporation, and she has filed the bill of complaint in this case to compel the directors of the corporation to declare and pay a dividend. The bill of complaint was dismissed by the court below, who filed a written opinion in the cause, which has been returned with the record.

The corporation was organized in 1875, with an authorized capital of $250,000, only $80, 000 of which was paid in. It did business until March, 1881, when a change was made in its stockholders, one of the Roberts purchasing the Throp interest, which was represented by 1,600 shares at $25 each, for which he paid $60,000. At this time the notes and money were divided, leaving the corporation without available capital or means to carry on the business. In this crisis the corporation resorted to borrowing, and from that time until December 12 following it had borrowed money and obtained credit to the amount of $37,903.71, of which $26,756.14 was represented by bills payable, and the balance in open account. The sales of its manufactured articles have been made in several states from Michigan to Texas and the Dakotas, and are made through agents or traveling salesmen, and mostly upon a credit of from three to four years. Notes of the purchasers have been taken upon sales, which, from the length of time and the distance of the parties, have not been bankable paper, and the corporation has been obliged to be a steady borrower and purchaser upon credit year by year. In 1882, its bills and accounts payable amounted at the close of business, December 12, to $72,954.54; in 1883, to $59,787.65; in 1884, to $89,989.91; in 1885, to $69,880.46; in 1886, to $84,088.15; in 1887, to $81,006.91. These items show that it required a large amount of ready money to carry on the business, and it was laid out in merchandise purchased, additional tools and machinery, and the expenses necessary to the manufacture and sale of the manufactured product, as shown in the respective accounts upon the books of the corporation. During the same time, the corporation steadily increased its bills receivable, which,

added to the debts due to the corporation upon open account, showed a steady increase of assets over liabilities year by year; yet the real value of such assets was much below their nominal value, owing to the nature of the credits, as before stated. Different witnesses familiar with this paper placed their estimate of its real value ranging all the way from 30 to 50 per cent less than its face. There is no testimony in the case showing, or tending in the remotest degree to show, that the business has not been well and economically managed. The salaries paid the officers are moderate and reasonable in amount, and, in my opinion, well earned. The proof is without contradiction that at no time since the complainant's intestate became a stockholder have the assets of the corporation been in a condition where a dividend to the stockholders could be made without serious detriment to the business of the corporation, by crippling its resources, and compelling it to discontinue business. Indeed, this fact is quite evident from the amount of capital required to carry on its business, the nature of its assets, and the amount of its liabilities.

The statute under which the corporation was organized provided that—

"If the directors of any such corporation shall declare and pay a dividend when the corporation is insolvent, or any dividend the payment of which would render it insolvent, knowing such corporation to be insolvent, or that the payment of such dividend would render it so, the directors assenting thereto shall be jointly and severally liable, in an action founded on this statute, for all debts due from such corporation at the time of paying or declaring such dividend."[1]

In view of such liability, a court of equity should pause and ponder well before compelling a board of directors to declare and pay a dividend in a case where each individual director testifies that the corporation cannot pay a dividend without serious injury to the business of the corporation, and the president and general manager testifies that such a step would have injured their business so that they would have had to wind it up. The statute also provides that the stock, property, affairs, and business of every such corporation shall be managed by its directors.

It is a well-recognized principle of law that the directors of a corporation, and they alone, have the power to declare a dividend of the earnings of the corporation, and to determine its amount. 5 *American and English Encyclopedia of Law*, 725. Courts of equity

[1] See How. Stat. sec. 4149.

will not interfere in the management of the directors unless it is clearly made to appear that they are guilty of fraud or misappropriation of the corporate funds, or refuse to declare a dividend when the corporation has a surplus of net profits which it can, without detriment to its business, divide among its stockholders, and when a refusal to do so would amount to such an abuse of discretion as would constitute a fraud, or breach of that good faith which they are bound to exercise toward the stockholders. Such is not the case here. The directors themselves own the largest share of the stock, and testify that they are anxious to receive a dividend whenever it can be made without injury to the business. They have not diverted nor misapplied the funds of the corporation. They have exercised the best of faith toward the stockholders. The books of the corporation show judicious management, and that a surplus of net earnings had accrued from year to year to and including the year 1887, which may be considered "net profits," which term has been defined to be what shall remain as the clear gains in any business venture after deducting the capital invested in the business, the expenses incurred in its conduct, and the losses sustained in its prosecution. *Park* v. *Locomotive Works*, 40 N.J. Eq. 114 (3 Atl. Rep. 162). By referring to the balance sheet at the close of the business December 12, 1887, it will be seen that the capital invested in the business was:

Real estate	$27,869.42
Tools and machinery	21,160.50
Merchandise	41,783.54
	$90,813.46
Bills payable	$56,917.07
Accounts payable	24,089.84
	$81,006.91

The items of the account under the head of "Real Estate," "Tools," etc., and "Merchandise," are not available for the payment of dividends, and may be set aside as so much capital invested in the plant and product. The resources out of which profits may be expected to arise at that date will have to be scaled down to actual value as shown by the testimony, and perhaps the lowest estimate placed upon them by the witnesses should be adopted, if we are to sit in judgment upon the discretion exercised by the directors in the

management of the business. The lowest estimate of the value of the bills receivable and accounts receivable is 50 per cent of their face value. The face value, as shown by the balance sheet of December 12, 1887, is as follows:

Bills receivable	$173,616.16
Accounts receivable	87,179.90
Total face value	$260,796.06
50 per cent of this is	$130,398.03
Add cash in bank and safe is	2,396.05
	$132,794.08

If from this sum we deduct the bills and accounts payable as above stated, there remains $51,787.17 as net profit. Now, since in this calculation all the liabilities have been provided for, and all losses likely to arise from the conversion of the notes and accounts into money have been eliminated, and as the corporation has on hand merchandise of the value of $41,783.54, which consists of unsold manufactured articles, and raw material on hand to be used in manufacturing, it may be asked, why may not the whole or a considerable part of this net profit be appropriated to the payment of dividends to stockholders? The answer is that it would deprive the corporation of the means from which to carry on its business. If this class of assets could be converted into money, and the debts and liabilities of the corporation paid, it would leave a working capital in the hands of the directors of $51,787.17. This sum is insufficient to carry forward the business. The balance sheets from the books show that about $20,000, on an average, is paid out for merchandise, which, in this instance, is the raw material, wood, and iron, etc., used in manufacture. The expense account, as contained in the balance sheet of December 12, 1887, shows that the operating and other expenses of 1887 were $56,765.26 required to carry on the business a year. This shows that the $51,787.17 could not be drawn out from the business and dividend without disaster, and compelling a winding up of the corporation. It is true that the directors would have on hand merchandise of the value of $41,783.54, consisting of manufactured articles and material for manufacture, but this could not be made available as a means to carry on the business, for the expense of manufacture must be met at once, and the necessities of the business require that sales

of manufactured goods shall be made upon three and four years' time, and the directors could derive no available means from this source to meet the necessary and current expenses of the business, and the result would be the utter inability of the corporation to continue business. Indeed, this is apparent from the fact that as the business is now conducted, with the notes maturing, the corporation is obliged to borrow money and obtain credit in open account to the amount of $81,006.91, as shown by the statement of December 12, 1887, for that year. And this is about an average for several years previous. It is evident that no dividend can be paid without borrowing the money for that purpose, and no court of equity will compel a board of directors, against their judgment and wishes, to borrow money to pay dividends.

The item in the trial balance called "Surplus Fund" is not an asset, but what is not fictitious is a liability, if anything. It is composed first of a fictitious entry of $40,000.00, supposed to represent premium on the stock. The balance is made up of the difference between the inventory of merchandise and the "Expense Account," which is called "net gain," and carried into the capital stock account as "Surplus Fund." If it represents capital stock, it is a liability equivalent to a stock dividend of that amount to be divided pro rata. It does not, however, represent a real asset, and is not carried into the financial statement of "Resources" and "Liabilities." The merchandise inventoried became converted into bills and accounts receivable, and these in turn are used in payment of liabilities. So that, in estimating the standing of the corporation, this "Surplus Fund" account must be entirely omitted. This "Suspense Account" as kept is a fictitious account. It was opened for convenience, and was designed to represent losses upon debts due the corporation, estimated at 10 per cent of all such debts. The testimony shows that this estimate was too small, and that such losses equaled or exceeded 30 per cent.

For reasons stated above and in the opinion of the circuit judge, I am of the opinion that the decree should be affirmed, with the costs of this court.

QUESTIONS

1. The D Company, having no surplus, declares and pays a dividend to its stockholders. After having taken this action, the corporation is unable to pay its creditors. What are the rights of the creditors under the circumstances?

2. The D Company, having declared a dividend, paid a portion thereof to S, whose name appeared on the books of the corporation as owner of ten shares of stock. As a matter of fact S had sold his stock to B before the declaration of dividends. What are B's rights against the corporation?
3. The corporation has a large surplus from which it ought to declare dividends. S, a stockholder of the corporation, brings an action for his share of the surplus. What decision?
4. The corporation has a surplus from which it might properly declare dividends. The directors refuse to do so and assign as a reason for its refusal that the surplus is needed for necessary expansion in the business. What are the rights of the stockholders, if any, under the circumstances?
5. The directors of the corporation declare a dividend. (*a*) At the same meeting they vote to rescind the declaration of dividends. (*b*) At a subsequent meeting, but before an announcement of the action, the directors vote to rescind the declaration. (*c*) At a subsequent meeting, after an announcement of the action had been made, the directors vote to rescind the declaration. What are the rights of S, a stockholder, against the corporation under each hypothesis?
6. The corporation declares a dividend. Before S is paid the corporation becomes insolvent. What are S's rights against the corporation under the circumstances?

FIDELITY TRUST COMPANY *v.* LEHIGH VALLEY RAILROAD COMPANY

215 Pennsylvania State Reports 610 (1906)

POTTER, J. As to the first question, whether or not the dividends upon the preferred stock are under the contract cumulative, we feel that sound reason, and the weight of authority, both English and American, are in accordance with the conclusion reached by the court below.

The act of March 4, 1850, under which the preferred stock was issued, provides as follows:

> And the said additional stock so issued shall be entitled to a preference over all the other stock of the said company, in every future dividend of profits which may be declared by the said company, until the holders of such additional stock shall have been paid from the funds applicable to the payment of such dividend, 10 per cent per annum on the amount of the capital stock of the company represented by said shares of additional stock so held by them respectively; and the holders of the other stock of the company shall not be entitled to participate in any future dividend of the

profits of the company till the holders of said additional stock shall have been paid from the funds applicable to such dividend, 10 per cent per annum on the amount of the capital stock of the company represented by said additional shares so held by them respectively.

There is no provision in the statute bearing directly upon the question of cumulation, and in the absence of any specification to the contrary the general rule would seem to be, that the preferred stock is entitled to arrears. While the act specifies that the preferred stockholders are to be paid from the profits, 10 per cent per annum, before the holders of other stock are entitled to participate at all, we can see in the language no limitation that the rights of the preferred stockholders are conditional upon the earning of sufficient profits each year to discharge their claim. No matter in what form the guarantee of dividends may be made, they can be paid only out of the net profits. An agreement to pay even though there be no profits, would be void as against public policy. Since their payment then depends upon profits, it would be postponed during years of business depression which showed no net profits. In the present case there is no guarantee of profits, or of payment of dividends every year, but there is an agreement that whenever there are profits to divide the holders of preferred stock shall receive of them at the rate of 10 per cent per annum on the amount of his holding.

In 9 *American and English Encyclopedia of Law* (2d ed.), 699, the prevailing principle applicable to such a situation is thus summed up: "The general rule is that where the holder of such preferred stock is declared to be entitled to a fixed sum per annum, without limiting the sum to be paid as dividends to profits earned when made within a designated period, the holder of the preferred stock has a prior claim over the common stockholders on subsequent dividends to make up the deficiency."

In 1 Morawetz on *Priv. Corp.* (2d ed., 1886), section 458, it is said that "If a corporation has agreed or guaranteed that the holders of preferred shares shall be paid dividends at a certain rate per annum, and the profits at any time are insufficient to enable the company to perform its agreements, the arrears must be made up out of the profits subsequently earned; and no dividends can be paid to the holders of the common shares until the preferred shareholders have been fully paid." And in 2 Clark and Marshall on *Private Corporations* (190), section 529*d*, the rule is thus stated: "If the contract with the preferred stockholders guaranteed or entitled them in

general terms to a certain annual dividend, not making the dividend payable in each year dependent upon the profits of that year, the dividends are cumulative; and if the profits in any year are not sufficient to pay the dividend, it must be paid, in addition to subsequent dividends, out of the profits of subsequent years, before any dividends can be paid to the holders of common stock."

And again in 1 Cook on *Stockholders*, section 273, we find the decisions summarized, and the further suggestion that the rule as stated is in accord with the usages of the business community. The author says,

> If preferred stock is issued, without any mention of whether or not the dividends are cumulative, then the law makes it cumulative. As soon as there are net profits available for dividends, the corporation must pay the preferred dividends, and all arrears thereon before a dividend is declared on the common stock. This is a well-settled rule at common law in this country and in England, and is not only equitable, but is in accord with the understanding of the business community. The right of the preferred stockholders to arrears of dividend is not deemed waived by delay, nor in any way, except upon clear proof of intent to waive.

We regard the decision of this court in *West Chester, etc., Railroad Co.* v. *Jackson*, 77 Pa. 321, as covering substantially the same question as that now before us; and under the ruling in that case, the defendant company here is liable for the arrears in the payments of dividends at the rate of 10 per cent per annum. It seems to us that reasonable construction of the contract requires us to hold that it means simply that whenever there are profits to divide the company is to see to it that the holder of preferred stock has received the stipulated amount of 10 per cent per annum before making any award to the other stockholders. The case of *Henry* v. *Great Northern Railway Co.*, 1 DeG. & J. 606 (638), is recognized as the leading authority on the subject under consideration, and Lord Cranworth there makes a suggestion which has much force, as a reason for the view he adopts. He says,

> If the directors are, as probably they will be, ordinary shareholders, they will have an interest so from time to time to set aside portions of their funds for the benefit of the company in the next half-year as to prevent the preferred shareholders from receiving a dividend in full, and they will thus create a larger fund for the division on the next occasion, the entire benefit of which, on the argument of the defendant, will accrue to the benefit of the ordinary shareholders. . . . . When I see that on one con-

struction of those acts the legislature will have given to the directors an interest in opposition to their duty, and that on the other construction they will not have done so, I am led strongly to believe that the latter is the sounder interpretation.

In the present case, it is manifest that a greater advantage to the other stockholders would accrue, if the preferred stock be considered as noncumulative. No such object was of course before the directors in refraining from the payment of annual dividends, but the possible result shows how such a power might be exercised to deprive the preferred stockholders of their contract rights, and a construction that would permit of such a result is to be avoided. We are of the opinion that the dividends upon preferred shares were properly held to be cumulative.

Turning now to the second question: Are the preferred stockholders to be charged, as against the amount in arrears for the years from 1893 to 1904 with the amount paid in excess of 10 per cent during the years 1860, 1863, and 1866. The preference created by the statute gave to the holders of the preferred stock, the right to receive five dollars per share per annum on each share of stock held by them, before the other stockholders were entitled to anything. That was the extent of the preference. If the funds applicable to a dividend amounted to just enough for that purpose the other stockholders took nothing. But when each class of stock had been paid 10 per cent, they were equal, and equally entitled to partake of whatever remained in the fund applicable for dividend purposes. The preferred stockholders were not creditors, nor was the amount paid to them in excess of 10 per cent in any one year to be charged to them as an advance payment upon any future dividends that might be earned or divided in coming years. There was no preference shown in the distribution of these extra dividends. All the shareholders fared alike in so far as they were concerned. The preference created under the act of the assembly went only so far as to give to the preferred stockholders a right to claim the first proceeds out of the fund applicable to dividends, to the extent of five dollars per share per annum on their stock and no farther. After that amount was paid the common stockholders were entitled to participate, and did so participate, taking during the years when extra dividends were paid, the same amount per share as the preferred stockholders. So that the extra payments during the years mentioned cannot be considered as overpayments to the holders of preferred stock. If the

preferred stockholders had been limited, under the terms of the contract, to 10 per cent per annum in any one year, and all the balance of the fund had belonged exclusively to the common stockholders, then the contention that these extra dividends should be set off against the arrears would be sound. But there is no such limitation in the act. The preferred stockholders stood upon the same plane as the others, with the additional advantage that they had the first right to partake in the distribution of profits up to the limit of five dollars per share per annum, and if necessary, the whole amount of the profit might be taken for that purpose, even if thereby the other stockholders were excluded. We agree with the conclusion of the learned court below, that the holders of preferred stock are entitled to have the arrears paid to them by the defendant company, without any deduction on account of dividends paid at a time when there had been no deficit. In so far as the excess of such payments over the 10 per cent per annum to the preferred stockholders was concerned, it was declared not as a matter of preference, but an equal distribution to all stockholders.

The assignments of error are overruled, the appeal is dismissed, and the decree of the court below is affirmed.

QUESTIONS

1. What is the purpose of giving to certain stock preference as to dividends?
2. Does a preference as to dividends give the holders of preferred stock a right to the guaranteed amount when the corporation has no surplus?
3. S is holder of preferred stock of the D Company. The company has a surplus from which it might properly declare dividends but it does not do so. What are S's rights against the corporation?
4. The company paid dividends on neither common nor preferred stock for three years. It now has a large surplus and is contemplating a dividend by which preferred stockholders will receive their annual 8 per cent and common stockholders will receive a like amount. S contends that the preferred stock is entitled to dividends for the three years in which no dividends were paid before the common stock is entitled to anything. What decision?
5. The company has paid the preferred stockholders the amount guaranteed on their stock for a given year, has paid a like amount to holders of common stock, and still has a surplus which it contemplates dividing equally between common and preferred stock. The common stockholders contend that they are entitled to all the surplus after preferred stockholders have been paid their guaranteed amount. What decision?

CHAPTER V

MANAGEMENT OF THE BUSINESS UNIT

1. Keeping the Unit within Its Powers

a) Powers of the Unit

CHARLES RIVER BRIDGE *v.* WARREN BRIDGE

11 Peters' United States Reports 420 (1837)

In 1785 the legislature of Massachusetts incorporated certain individuals as the Charles River Bridge, authorized the corporation to erect a bridge over the Charles River and granted it the privilege of exacting toll for its use. Under a later enactment the legislature chartered the Warren Bridge and authorized it to construct a free bridge across the Charles River within a few rods of the Charles River Bridge. The Charles River Bridge brought this suit in equity and challenged the validity of the act providing for the Warren Bridge. The complainant contends that the act violates that provision of the constitution which declares that no "State shall pass any law impairing the obligation of contract." The members of the Supreme Court of Massachusetts were equally divided in opinion on the question at issue and accordingly dismissed complainant's bill.

TANEY, C. J. Much has been said in the argument of the principles of construction by which this law is to be expounded, and what undertakings, on the part of the state, may be implied. The court thinks there can be no serious difficulty on that head. It is the grant of certain franchises by the public to a private corporation, and in a matter where the public interest is concerned. The rule of construction in such cases is well settled, both in England, and by the decisions of our own tribunals. In 2 Barn. & Adol. 793, in the case of *Proprietors of the Stourbridge Canal* v. *Wheely and Others*, the court says: "The canal having been made under an act of parliament, the rights of the plaintiffs are derived entirely from that act. This, like many other cases, is a bargain between a company of adventurers and the public, the terms of which are expressed in the statute; and the rule of construction in all such cases, is now fully established to be this: that any ambiguity in the terms of the contract, must operate against

the adventurers, and in favor of the public, and the plaintiffs can claim nothing that is not clearly given them by the act." And the doctrine thus laid down is abundantly sustained by the authorities referred to in this decision. The case itself was as strong a one as could well be imagined, for giving to the canal company, by implication, a right to the tolls they demanded. Their canal had been used by the defendants, to a very considerable extent, in transporting large quantities of coal. The rights of all persons to navigate the canal were expressly secured by the act of parliament; so that the company could not prevent them from using it, and the toll demanded was admitted to be reasonable. Yet, as they only used one of the levels of the canal, and did not pass through the locks, and the statute, in giving the right to exact toll, had given it for articles which passed "through any one or more of the locks," and had said nothing as to toll for navigating one of the levels, the court held that the right to demand toll, in the latter case, could not be implied, and the company were not entitled to recover it. This was a fair case for an equitable construction of the act of incorporation, and for an implied grant, if such a rule of construction could ever be permitted in a law of that description. For the canal had been made at the expense of the company; the defendants had availed themselves of the fruits of their labors, and used the canal freely and extensively for their own profit. Still, the right to exact toll could not be implied, because such a privilege was not found in the charter.

Borrowing, as we have done, our system of jurisprudence from the English law, and having adopted, in every other case, civil and criminal, its rules for the construction of statutes, is there anything in our local situation, or in the nature of our political institutions, which should lead us to depart from the principle where corporations are concerned? Are we to apply to acts of incorporation a rule of construction differing from that of the English law, and, by implication, make the term of a charter in one of the states, more unfavorable to the public, than upon an act of parliament, framed in the same words, would be sanctioned in an English court? Can any good reason be assigned for excepting this particular class of cases from the operation of the general principle, and for introducing a new and adverse rule of construction in favor of corporations, while we adopt and adhere to the rules of construction known to the English common law, in every case, without exception? We think not; and it would present a singular spectacle, if, while the courts in England are

restraining, within the strictest limits, the spirit of monopoly, and exclusive privileges in nature monopolies, and confining corporations to the privileges plainly given to them in their charter, the courts of this country should be found enlarging these privileges by implication, and construing a statute more unfavorably to the public, and to the rights of the community, than would be done in a like case in an English court of justice.

Adopting the rule of construction above stated as the settled one, we proceed to apply it to the charter of 1785 to the proprietors of the Charles River Bridge. This act of incorporation is in the usual form, and the privileges such as are commonly given to corporations of that kind. It confers on them the ordinary faculties of a corporation, for the purpose of building the bridge, and establishes certain rates of toll, which the company are authorized to take. This is the whole grant. There is no exclusive privilege given to them over the waters of Charles River, above or below the bridge. No right to erect another bridge themselves, nor to prevent other persons from erecting one. No engagement from the state, that another shall not be erected, and no undertakings not to sanction competition, nor to make improvements that may diminish the amount of its income. Upon all these subjects the charter is silent, and nothing is said in it about a line of travel, so much insisted on in the argument, in which they are to have exclusive privileges. No words are used, from which an intention to grant any of these rights can be inferred. If the plaintiff is entitled to them, it must be implied, simply, from the nature of the grant, and cannot be inferred from the words by which the grant is made.

The relative position of the Warren Bridge has already been described. It does not interrupt the passage over the Charles River Bridge, nor make the way to it or from it less convenient. One of the faculties or franchises granted to that corporation has been revoked by the legislature, and its right to take the tolls granted by the charter remains unaltered. In short, all the franchises and rights of property enumerated in the charter, and there mentioned to have been granted to it, remain unimpaired. But its income is destroyed by the Warren Bridge, which, being free, draws on the passengers and property which would have gone over it, and renders their franchise of no value. This is the gist of the complaint. For it is not pretended that the erection of the Warren Bridge would have done them any injury, or in any degree affected their right of property,

if it had not diminished the amount of their tolls. In order then to entitle themselves to relief, it is necessary to show that the legislature contracted not to do the act of which they complain, and that they impaired, or, in other words, violated that contract by the erection of the Warren Bridge.

The inquiry then is, does the charter contain such a contract on the part of the state? Is there any such stipulation to be found in that instrument? It must be admitted on all hands that there is none—no words that even relate to another bridge, or to the diminution of their tolls, or to the line of travel. If a contract on that subject can be gathered from the charter, it must be by implication and cannot be found in the words used. Can such an agreement be implied? The rule of construction before stated is an answer to the question. In charters of this description, no rights are taken from the public, or given to the corporation, beyond those which the words of the charter, by their natural and proper construction, purport to convey. There are no words which import such a contract as the plaintiffs in error contend for, and none can be implied, and the same answer must be given to them that was given by this court to the Providence Bank. The whole community are interested in this inquiry, and they have a right to require that the power of promoting their comfort and convenience, and of advancing the public prosperity, by providing safe, convenient, and cheap ways for the transportation of produce and the purposes of travel, shall not be construed to have been surrendered or diminished by the state, unless it shall appear by plain words that it was intended to be done.

The judgment of the supreme court of Massachusetts, dismissing plaintiff's bill, must, therefore, be affirmed with costs.

QUESTIONS

1. What are the sources of the powers of a corporation?
2. Compare a corporation with a partnership in respect to the powers which it may exercise.
3. It is said that the following powers are peculiar to corporate existence and are implied even when not granted: (*a*) the power of perpetual succession; (*b*) the power to sue and be sued in a corporate name; (*c*) the power to receive, hold, and transfer property for corporate purposes; (*d*) the power to have a corporate seal; (*e*) the power to make by-laws for corporate government; and (*f*) the power to expel members. Why should these powers be implied?

4. What is meant by franchise? What is the difference between the powers and franchises of a corporation?
5. When is the principle announced by CHIEF JUSTICE TANEY in this case applicable in the construction of corporate charters?
6. When a corporation is exceeding its corporate powers, what parties are in a position to object?

NICOLL *v.* THE NEW YORK AND ERIE RAILROAD COMPANY

12 New York Reports 121 (1854)

PARKER, J. The grant from Dederer to the Hudson and Delaware Railroad Co., bearing date the first day of July, 1835, was made to that company, and their successors. Under that grant, there can be no doubt that Hudson and Delaware Railroad Co. took a fee. The word of perpetuity used would have been sufficient to describe a fee, even under the most strict requirements of the common law.

The company had ample power to purchase lands. It was a power incident at common law to all corporations, unless they were specially restrained by their charters or by statute. (2 Kent, 281; Co. Litt., 44*a*, 300*b*. 1 Kyd on *Corporations*, 76, 78, 108, 115; 3 Pick. 239.) And in this case the power was expressly conferred by the ninth section of the charter (Sess. Laws of 1835, p. 113); and by the sixteenth section there were given to it the general powers conferred upon corporations (1 R.S. 731), one of which is that of holding, purchasing, and conveying such real estate as the purposes of the corporation may require. But if no words of perpetuity had been used, the grantor owning a fee, the company would have taken a fee, for the statute is now imperative, that every grant shall pass all the estate or interest in the grantor, unless the intent to pass a less estate or interest shall appear by express terms or be necessarily implied in the terms of grant. (1 R.S. 748, sec. 1.)

But it is objected that, because by the act of incorporation, there was given to it only a term of existence of fifty years (Laws of 1835, p. 110, sec. 1), therefore the grant shall be deemed to have conveyed an estate for years, and not in fee. The unsoundness of that position is easily shown. It was never yet held, that a grant of a fee in express terms could be restricted by the fact that the grantee had but a limited term of existence. If it were so, a grant could never be made to an individual in fee, because, in his earthly existence, he is not immortal. Under such a rule, a man could never buy a greater

interest in a farm than a life estate. It would follow that all estates would be life estates, except those held by perpetual corporations. The intent of parties, fully expressed in a deed, would avail nothing, but all grants would be measured by the mortality of the grantee. It is needless to follow out the proposition further to show its absurdity.

It is not to the parties to a grant, but its terms, that we look to ascertain the character and extent of the estate conveyed. (1 R.S. 748, sec. 1.) The change made by the statute favors the grantee, where there are no express terms in the grant, presuming the grantor intended to convey all his estate.

It is erroneous to say that an estate in fee cannot be fully enjoyed by a natural person, or by a corporation of limited duration. It is an enjoyment of the fee to possess it, and to have the full control of it, including the power of alienation by which its full value may at once be realized.

It is well settled that corporations, though limited in their duration, may purchase and hold a fee, and they may sell such real estate whenever they shall find it no longer necessary or convenient. (5 Denio, 389; 2 Preston on *Estates*, 50.) Kent says: "Corporations have a fee simple for the purpose of alienation, but they have only a determinable fee, for the purpose of enjoyment. On the dissolution of the corporation, the reverter is to the original grantor or his heirs, but the grantor will be excluded by the alienation in fee, and in that way the corporation may defeat the possibility of a reverter." (2 Kent, 282; 5 Denio, 389; 1 Comst. R. 509.) Large sums of money are accordingly expended by railroad companies in erecting extensive station houses and depots, and by banking corporations in erecting banking houses, because, holding the land in fee, they may be able to reimburse themselves for the outlay by selling the fee before the termination of their corporate existence.

QUESTIONS

1. The D Company is incorporated with power to construct and operate a sawmill. No express power is given to the corporation to purchase and hold property. Does it have power to acquire and hold real and personal property? If so, to what extent?
2. The corporation is given express power to acquire and hold such real and personal property as may be necessary for the conduct of its business. Can this corporation take real and personal property under a will?

3. The corporation is negotiating for a farm near its plant, expecting to sell in the future at a profit. The minority stockholders ask that the corporation be enjoined from making the purchase. What decision?
4. The corporation contracted for five acres of land near its plant, not because it was then needed, but because it might be needed in the near future for the business which is rapidly expanding. The minority stockholders ask that the corporation be enjoined from making the purchase. What decision?
5. The B Company was incorporated with power to engage in the banking business. It made a loan of $5,000 to D and received from him a mortgage on his farm. The bank brought proceedings to foreclose the mortgage when the debt matured. D contended that the mortgage was void because the corporation had no power to hold real estate except for banking purposes. What decision?

COLEMAN *v.* HAGEY

252 Missouri Reports 102 (1913)

WALKER, J. Free from the impress of a trust or lien, as is the property of a solvent business corporation, its right to dispose of its property in such manner as it chooses, subject, of course, to regulatory statutes, would seem to follow as a natural consequence of unrestricted ownership, the one being the correlative of the other. In many of the cases we have heretofore discussed defining the trust fund theory, the right to dispose of assets has been declared as one of the attributes of solvent corporate existence. Authorities expressly in support of the right are, however, numerous and conclusive.

A certain class of corporations are excepted from the rule authorizing them to sell their assets, the exception and the rule being clearly stated in an early Massachusetts case as follows:

> Corporations established for objects quasi-public, such as railway, canal, and turnpike corporations, to which the right of eminent domain and other large privileges are granted in order to enable them to accommodate the public, ... and also charitable and religious bodies . . . . may perhaps be restrained from alienating their property, and compelled to appropriate it to specific uses. . . . . But it is not so with corporations of a private character, established solely for trading and manufacturing purposes. Neither the public nor the legislature has any direct interest in their business or its management. These are committed solely to the stockholders, who have a pecuniary stake in the proper conduct of their affairs. By

accepting a charter, they do not undertake to carry on the business for which they are incorporated, indefinitely, and without any regard to the condition of their corporate property. [*Treadwell* v. *Salisbury Manufacturing Co.*, 7 Gray (Mass.), 393, 404.]

The St. Louis Court of Appeals, speaking through GOODE, J., in *Jorndt* v. *Hub & Spoke Co.*, 112 Mo. App. 1. c. 344, said: "When there are no stockholders except the directors and officers, the latter may, if they wish, give away an asset by unanimous consent, and the gift will be good, unless the rights of creditors are impaired. All the stockholders of a corporation may consent to an appropriation of an asset by an official if the appropriation would not be detrimental to creditors." The rule announced in the singular number in this case would be equally true if stated in the plural in reference to assets.

JUSTICE SHELDON of the supreme court of Illinois in *Reichwald* v. *Hotel Co.*, 106 Ill. 439, said: "But it is claimed that the board of directors did not have the power to dispose of all its property, and thus destroy the corporation. The effect of this transfer of all the hotel property no doubt was to terminate the business of the corporation; but that was not the necessary effect. It is entirely clear, upon the authorities, that the disposal of all of the property of a corporation has not the effect to end or dissolve the corporation." It is not inappropriate to state in connection with this ruling that the corporation in the case at bar was organized under the laws of the state of Illinois.

JUDGE HAIGHT in a New York Court of Appeals case of *Holmes & Griggs Manufacturing Co.* v. *Holmes & Wessell Metal Co.*, 127 N.Y. 252, said: "The plaintiff had the right, with the consent of its stockholders, to sell its plant and retire from business; and it appears from the evidence in this case that the consent of all the stockholders was given to the sale that was made. . . . . Inasmuch as this was done with the consent of all the stockholders, it being the act of a private corporation, not in any manner harming the public, we see no reason for condemning its title to the stock so obtained." And the rule is clearly stated in 7 *American and English Encyclopedia of Law*, 734, as follows: "And by the weight of authority, both in England and in the United States, a strictly private commercial corporation, owing no particular duties to the public, may, with the consent of all the shareholders, in the absence of express or implied restrictions

in its charter, or prejudice to the rights of creditors, transfer all its property to another corporation or person, if the latter is capable of taking. And it may do so, even though the effect may be to render it incapable of further carrying on its business."

In the late case of *Mooreshead* v. *United Railway Co.*, 203 Mo. 121, this court speaking through GRAVES, J., said that where there is no bar in the statute or corporate articles, a solvent corporation may dispose of its assets as it may deem to its advantage, the same as a natural person. We find no variance from or exceptions to this rule or right of corporations under the conditions stated, either in texts, treatises, or adjudicated cases. Without further burdening this opinion with quotations it may be said generally that the following cases affirmatively announce the unrestricted right of solvent corporations which have no liabilities to dispose of their capital stock in such manner as they deem proper. (*Brown* v. *Schleier*, 194 U.S. 18; *People ex rel. Electric Co.* v. *Barker*, 141 N.Y. 251; *Carr* v. *Rochester Tum Co.*, 207 Pa. St. 392; *Stockton* v. *Am. Tob. Co.*, 55 N.J. Eq. 352; *Miller* v. *Am. Tob. Co.*, 56 N.J. 847; *Rochester Railroad Co.* v. *Rochester*, 205 U.S. 236, 256; *Willamette Manufacturing Co.* v. *Bank*, 119 U.S. 191, 198; *Great Western M. & M. Co.* v. *Harris*, 128 Fed. 321.)

Not only do solvent corporations without liabilities have the unrestricted right with the approval of their shareholders, to dispose of their assets, but they may also sell and transfer their charters or corporate franchises and vest same in others. The sale and transfer in such cases is, in legal effect, but a surrender or abandonment of the old charter by the corporation and a grant *de novo* of the charter to the transferees or purchasers. (*State ex rel.* v. *Sherman et al.*, 22 Ohio St. 411; 1 Wilgus on *Corporations*, p. 1082.) The right of disposition of either assets of franchises of a corporation, is, as to their effect, to be measured by the following rules: First, the character of the sale and transfer is to be determined by the circumstances existing at the time it took place (*McCole* v. *Loehr*, 79 Ind. 430); second, if a grantor remains solvent after the sale and transfer of its assets, and has sufficient property left to pay all of its then existing debts, its conveyance cannot be regarded as a fraud upon creditors (*Kain* v. *Larkin*, 131 N.Y. 300, 307); third, one assailing a transfer assumes the burden of showing that it was made in bad faith and that it left the grantor without ample property to pay its then existing debts. (*Nevers* v. *Hack*, 138 Ind. 260; *Holden* v. *Burnham*, 63 N.Y. 74; *Penace* v. *Croan*, 51 Ind. 336.)

QUESTIONS

1. The D Company, incorporated for the purpose of carrying on a manufacturing business, was authorized by its charter to acquire and hold real and personal property for corporate purposes. (*a*) It executed a mortgage on its machinery to secure a debt it owed. (*b*) It sold a tract of land which it owned to get money with which to pay other debts. S, a stockholder, asks that these transactions be declared void because the corporation had no power to enter into them. What decision?
2. The D Company, incorporated for the purpose of constructing and operating a railroad, was authorized to acquire and hold property for corporate purposes. It entered into a contract to sell a piece of land which it acquired under the power of eminent domain. Discuss the validity of the contract.
3. The D Company, engaged in the insurance business, proposes to pay a loss to X, although the loss was not covered by X's insurance policy. The minority stockholders ask that the corporation be enjoined from making the payment. What decision?
4. The D Company, engaged in the hotel business, proposes to give $5,000 as an inducement to secure the national nominating convention of the Democratic party in the city where it operates its hotel. Discuss the validity of the proposed action.
5. The D Company, engaged in manufacturing and selling breakfast food, proposes to give away $5,000 worth of its products for advertising purposes. S, a stockholder in the corporation, asks that the corporation be enjoined from making the gift. What decision?

BROWN *v.* WINNISIMMET COMPANY

11 Allen's Massachusetts Reports 326 (1865)

The suit is founded on an agreement which the defendant company agreed to charter to plaintiffs their iron ferry boat "Winnisimmet," with the understanding that she was to be rechartered to United States. Plaintiffs to pay $125 per day rent, and account to the company for one-half of all sums realized on a rechartering in excess of $125 per day under a charter executed. The company has collected from the United States at the rate of $200 per day. The declaration was on an account annexed. One item being a charge of $1,650 for one-half, cash due and paid by the United States to the defendant company as charter money. Plaintiffs had verdict and defendants allege exceptions. Among other questions presented on appeal was whether or not the company had authority under its charter to make the lease in question.

BIGELOW, C. J. The main defense to this action appears to have been that the contracts or agreements on which the plaintiffs rely in support of their claim against the defendants were such that the latter had no power or authority to make them under the act of the legislature by which they were incorporated, and that they cannot for that reason be enforced in a court of law. The later English authorities seem to sanction the doctrine that such a ground of defense, although it may be "unbecoming and ungracious," or, in the stronger language of LORD ST. LEONARDS, "indecent" is nevertheless legal and valid, if it be made to appear, either by the express provisions of an act of incorporation or by necessary and reasonable application therefrom, that a contract which is sought to be enforced in an action at law against a corporation is beyond the scope of the powers granted by its charter; or, in other words, that the legislature did not intend that the body created by them should enter into contracts of a character like that which the plaintiff makes a foundation of a claim against it. *South Yorkshire Railway, etc.* v. *Great Northern Railway*, 9 Exch. 55, 85. *Hood* v. *New York and New Haven Railroad*, 22 Conn. 502; *Pearce* v. *Madison & I.R. Co.*, 21 How. 441, 16 L.Ed. 184; Angell and Ames on *Corporations*, 256, and cases cited. It is on the principle which seems to be adopted by these authorities that the defendants rely to defeat the present action.

We have no occasion now to examine at length into the correctness of this doctrine, or to ascertain with precision its proper limitations or operation, because we are of opinion that the defendants do not bring the case at bar within any recognized application of the rule. Looking only at the words of the act by which the defendants were incorporated, St. 1833, c. 197, we are unable to say that the contracts on which the plaintiffs rely are so far foreign to the object for which a charter was granted to the defendants as to require us to declare them to have been *ultra vires* and illegal, and that no action upon them can be maintained in a court of law. In the absence of all evidence of extraneous facts, and taking the case as it was presented at the trial, on a comparison of the contracts set by the plaintiffs with the act incorporating the defendants, it appears to us that the scrupulous care and anxiety to keep within the limit of their corporate powers, which the defendants now manifest, will not avail them in defense of this action, although it may induce them to exercise a greater caution in entering into contracts which they cannot fulfil without violating their charter. They were incorporated with

power to establish, continue, and maintain a ferry between the city of Boston and the town of Chelsea, and were authorized to own, hold, and possess vessels, steamboats, and such other property, not exceeding in value one hundred thousand dollars, as might be necessary and convenient for the better management of such ferry and of the affairs of said corporation. There can be no doubt that under this charter the main purpose for which the defendants were incorporated was to carry on the transportation of persons, vehicles, merchandise, and other articles by means of a ferry across Charles River between the points designated in the act. All else was to be subordinate and incidental to this main design. So far, the argument urged in behalf of the defendants is sound and irrefragable.

But the next step is not so easily taken, nor does it lead to the point at which the defendants seek to arrive. It was not shown at the trial that the steamboat which was the subject of the contracts with the plaintiffs was not a necessary and proper vessel to be used by the defendants in the prosecution of the business of their ferry, nor that by reason of its ownership they had exceeded the limit of personal property which they were empowered by their charter to hold. Nor could it be properly inferred that it was not reasonably required for the legitimate business of the corporation, because it was not in actual use by them on the ferry at the time the contract for letting it was entered into with the plaintiffs, and because it was chartered under the contract for the use of the government of the United States. Such an inference could be made only on the theory that the defendants were so restricted by their charter that they could not hold any greater number of vessels or steamboats than were absolutely required for present or immediate and constant use on their ferry, or, if they could be allowed to possess a larger number, that they could not use or employ them in any other business or for any other purpose whatever, but must suffer them to remain at their wharf to decay or deteriorate for the want of use, or, at least, in a condition in which they could be of no advantage to themselves or others.

But we think such a narrow and restricted construction of the powers granted to the defendants is inconsistent with any reasonable view of the intention of the legislature in conferring on them a corporate franchise, and is not required by any considerations of justice or sound policy. On the contrary, we cannot doubt that under their charter they are authorized to hold any amount or kind of personal property, within the limit of value fixed by the

act, which they may deem necessary or expedient for the proper conduct and management of the business of the ferry; that it is no excess of their corporate powers to own steamboats which are not required for immediate or constant use in the daily prosecution of their ordinary business but which may be convenient or useful in case of sudden emergency or accident, or when those which are employed in the regular service of the ferry might be withdrawn for repairs; that it is not necessary that such extra or additional steamboats should be kept unemployed when not required for the business of the ferry, but that it is competent for the defendants to use them or to let them to others to be used in carrying on any legitimate business for which they are suitable, such as the towage of vessels and the transportation of passengers or merchandise, so long as such use is only temporary and incidental to the main purpose for which they are owned by the defendants.

We know of no rule or principle by which an act creating a corporation for certain specific objects or to carry on a particular trade or business is to be strictly construed, as prohibitory of all other dealings or transactions, not coming within the exact scope of those designated. Undoubtedly the main business of a corporation is to be confined to that class of operations which properly appertain to the general purposes for which its charter was granted. But it may also enter into contracts and engage in transactions which are incidental or auxiliary to its main business, or which may become necessary, expedient, or profitable in the care and management of the property which it is authorized to hold under the act by which it was created. For example, it might perhaps be held that a corporation established for the purpose of manufacturing cotton and woollen cloth could not properly invest all its capital in mill powers and privileges, and engage exclusively in the business of leasing them to others to be used for manufacturing purposes, or that it could not lawfully confine its operations to the making of steam-engines and machines for sale. But no one could doubt that it would be within the scope of its powers to allow another person or corporation, for a reasonable compensation, to draw surplus water from its mill pond, or to employ that portion of its steam power which was not required for its own use. So a stage coach company or a street railway corporation would exceed its corporate powers if it engaged extensively in the transportation of passengers and merchandise on land or sea by steam; but it would be acting strictly within the limits of its

capacity if it should occasionally let a horse or a coach or car, not required for its own immediate purposes, to another person or corporation, or should enter into a contract for the employment of its horses in another occupation during a portion of the year when the business of the corporation did not require their use. We can see no substantial difference between transactions of this character and that which the defendants entered into when they made the contracts with the plaintiffs.

These views of the extent of the authority granted to the defendants by the legislature are a decisive answer to the defense relied on by them at the trial. The steamboat, under the contract with the plaintiffs, was let to the United States in a season of great public exigency, for military purposes; the defendants did not part with her control for any definite period of time, but only from day to day, nor did they send her to a great distance, where she could not be speedily recalled. The defendants retained the right and power to resume the possession and use of her at any moment. In this state of facts, we are of opinion that the court below took a correct view of law, and was right in refusing to rule, as requested by the defendants, that the contracts entered into with the plaintiffs were not authorized by the defendants' charter, and were therefore void.

Exceptions overruled.

QUESTIONS

1. Where did the corporation in this case get the power to lease a part of its property to the plaintiffs? Would the decision have been the same in case the corporation had leased all of its property to the plaintiffs?
2. The D Company was incorporated with power to manufacture and sell gas. It later began manufacturing and selling gas fixtures in order to increase the sale of gas. S, one of its stockholders, asks that the corporation be enjoined from engaging in this new business. What decision?
3. The B Company was incorporated with power to conduct a banking business. It proposes to erect a ten-story building, to use two floors of the building for banking purposes, and to lease the remaining space. Discuss the validity of the proposed action.
4. What is the test for determining whether a given undertaking, not expressly authorized, is *ultra vires* on the part of a corporation?

NORTHSIDE STREET RAILWAY COMPANY *v.* WORTHINGTON

88 Texas Reports 562 (1895)

The Fort Worth City Co. and the Northside Street Railway Co. were both organized under the general incorporating laws of the

state of Texas; the purpose of the first being, "the purchase, subdivision, and sale of lands in cities, towns, and villages:" and that of the second, "the construction and maintenance of street railways." Neither corporation had any express power to extend its credit in aiding the other. The two corporations jointly issued bonds, secured by a mortgage on their joint property to promote a scheme of suburban development. This was a suit by bondholders against the Northside Street Railway Co., the Fort Worth City Co., and other defendants, on these bonds. At the trial the plaintiffs prevailed, securing judgment on the bonds with foreclosure of the mortgage.

GAINES, C. J. It is contended on behalf of the plaintiffs in error, that the execution of the bonds was *ultra vires*, and that therefore they are void. In determining this question, we may recur to a few leading principles. Corporations are the creatures of the law, and they can only exercise such powers as are granted by the law of their creation. An express grant, however, is not necessary. In every express grant, there is implied a power to do whatever is necessary or reasonably appropriate to the exercise of the authority expressly conferred. The difficulty arises, in any particular case, whenever we attempt to determine whether the power of a corporation to do an act can be implied or not. The question has given rise to much litigious controversy, and to much conflict of decision. It is not easy to lay down a rule by which the question may be determined; but the following, as announced by a well-known text writer, commends itself not only as being reasonable in itself, but also as being in accord with the great weight of authority:

> Whatever be a company's legitimate business, the company may foster it by all the usual means; but it may not go beyond this. It may not, under the pretext of fostering, entangle itself in proceedings with which it has no legitimate concern. In the next place, the courts have however determined that such means shall be direct, not indirect; i.e., that a company shall not enter into engagements, as the rendering of assistance to other undertakings from which it anticipates a benefit to itself, not immediately, but immediately by reaction, as it were, from the success of the operations thus encouraged—all proceedings inevitably tending to breaches of duty on part of the directors, to abandonment of its peculiar objects on part of the corporation. [Green's Brice's *Ultra Vires*, 88.]

In short, if the means be such as are usually resorted to and a direct method of accomplishing the purpose of the incorporation, they are within its powers; if they be unusual and tend in an indirect

manner only to promote its interests, they are held to be *ultra vires*. For example, a railroad company may establish and maintain refreshment houses along its line for the accommodation of its passengers. *Flanagan* v. *Railroad*, L.R. 7 Eq., 116. Such establishments are not unusual, are strictly subordinate to the main purpose for which such companies are created, and tend immediately to increase their traffic. So it has been held, that a railroad corporation has the power to contract with the owner of a steam vessel to maintain a through traffic and carry beyond its line, and that it can recover of the owner of such vessel damages to goods resulting from its unseaworthiness, for which the company has had to pay. *South Wales Railway Company* v. *Redmond*, 10 C.B., N.S., 675. It is now generally recognized, that a railway company may contract to carry beyond its line, and it would seem to follow, that a reasonable traffic arrangement with another carrier for through transportation is legitimate. On the other hand, in *Coleman* v. *The Eastern Counties Railway Co.* 10 Ber., 1, the performance of a contract by which the company sought to establish a line of steamships between a terminus of one of its branches and a foreign port, and by which it attempted to guarantee a dividend on the venture, was enjoined. Upon a hasty consideration, the two cases may appear not clearly distinguishable; but we think them entirely consistent, and that they well illustrate the rule which we have stated. In the former, the contract was subsidiary to the legitimate business of the company, and was such as was reasonable and appropriate to a railroad, one of the termini of which was upon seashore. It tended directly to increase the traffic of the company. In the latter, the establishment of the line of steamships was not subordinate to the business of the railroad company, but was in its nature a distinct enterprise. It tended to increase the business of the port to which the company's branch line extended, and the increase of the business of the port tended to increase the traffic of the railroad; but this was a mediate, and not a direct result.

In *Davis* v. *Railway*, 131 Massachusetts, 258, it is held, that it is beyond the powers of a railway company, or of a corporation organized under the general statutes of Massachusetts for the manufacture and sale of musical instruments, to guarantee the payment of the expenses of a musical festival. The opinion in that case is by Chief Justice Gray, and is a very able and exhaustive discussion of the question.

In *Pearce* v. *Railway*, 21 Howard, 441, it was held, that two railroad companies which had consolidated were not authorized to establish a steamship line to run in connection with their railroads.

In *Plymouth Railway* v. *Colwell*, 39 Pennsylvania State, it was decided, that a railway company was not authorized by its charter to maintain a canal.

In *Timkinson* v. *Railway*, Law Reports, 35 Chancery Division, 675, it was held, that a proposed subscription by the company to an institution known as the "Imperial Institute" was not prevented from being *ultra vires* by the fact that the establishment of the institute might benefit the company by causing an increase of passenger traffic over their line.

These principles, applied to the facts of this case, lead to the conclusion, that neither the Fort Worth City Co. nor the Northside Street Railway Co. had the power to extend its credit to foster the interests of the other company. Viewed in the light of the peculiar facts of the case, it is apparent that the building up and settlement of the suburb tended to increase the business of the street railway which connected that suburb with the city of which it was the outgrowth. On the other hand, it is equally clear that the establishment of the street railway tended to promote the enterprise of the other corporation. It is also clear, that the establishment and maintenance of a street railway is not an object which was expressed in the articles of incorporation of the city company, and that the building up of an addition to a city is not a purpose expressed in the charter of the other corporation. That the success of the one enterprise tended to promote the success of the other was not itself sufficient to authorize the one corporation to aid the other, for the reason that the benefit which was to accrue was not the direct result of the means employed.

The transaction in controversy, when properly analyzed and stripped of its form, is one in which the two corporations agreed to borrow a sum of money to be divided between them, and that each should become the surety for the other for the amount received by such other. It is too well settled to require the citation of authority, that a corporation of the character of those in question, in the absence of statutory authority, cannot bind itself by accommodation paper executed for the benefit of another party. It follows, that if either corporation in this case is to be held bound for more than its proportionate amount of the debt incurred, it must be upon the ground that it had power to aid in the prosecution of the business of the other.

Did the street railway company have such power? If it is to be held, that because of the indirect benefits which would result to it from the success of the enterprise, it was authorized by the law to aid in building up the suburb of the city company, then it should also be held, that it had the power to employ its funds and its credit in fostering to any other undertaking which was calculated to increase the population of the city of Fort Worth or of any portion of the territory which lies along its line. The effect of that ruling would be to empower every business corporation not only to carry on the very business it was created to prosecute, but also to engage in every enterprise which would tend to increase the volume of its principal business and the revenues to be derived therefrom. This would leave the scope of its operations without any reasonable limit. That such is not the law, the authorities already cited are sufficient to show. Street railways are projected for the carriage for hire of people living within the near cities and towns. Street railway companies are chartered for the specific purpose of establishing and operating street railways, and not to increase the population of the towns and cities through which they are established—though their operation may have that effect, and though an increase of population may result indirectly to their benefit.

Cities and towns have grown up without the aid of street railways. The origin of the latter is comparatively very recent. The law does not recognize them as a usual means of carrying out the purpose of a corporation organized to purchase and subdivide lands and to sell them in lots. They are provided for in the general law as a distinct purpose for which corporations may be created. The two enterprises may be of mutual assistance; and if the same persons desire to form two distinct corporations for the prosecution at the same time of two undertakings, with a view to the mutual benefit which may result from the concurrent operation of the two, no reason is seen why they should not do so. But each should confine itself to its proper business, and should not divert its capital or extend its credit to the assistance of the other.

QUESTIONS

1. What test does this case announce for determining whether a given undertaking of a corporation is authorized by its charter?
2. The D Company was incorporated with power to operate a railroad from X to Y, a distance of about 3,000 miles. It later bought and began to operate boats from X to Z, about 50 miles across the lake from X.

S, a stockholder in the corporation, asks that the corporation be enjoined from continuing the operation of the boats. What decision?

3. There was no good hotel in Y. The corporation accordingly let a contract for a hotel building to be erected near its terminal station in Y. It later changed its plans and refused to perform the contract. In an action against the corporation on this contract, the corporation pleads *ultra vires*. What decision?
4. The D Company was incorporated for the purpose of manufacturing and selling boots and shoes. It later began to manufacture and sell hats. S asks that the corporation be enjoined from engaging in the hat business. What decision?
5. The D Company was incorporated with power to manufacture and sell building materials. The corporation entered into a contract with X, a contractor, by which it guaranteed the faithful performance of a building contract by X in consideration of X's promise to buy all his materials from the corporation. Discuss the validity of this contract.

MONUMENT NATIONAL BANK *v.* GLOBE WORKS

101 Massachusetts Reports 57 (1869)

HOAR, J. The single question presented for our decision in this cause, all others which arise upon the report having been waived, is, whether the note of a manufacturing corporation, in the hands of a holder in good faith for value, who took it before maturity, and without knowledge that the makers had not received the full consideration, cannot be enforced against them, because it was in fact made as an accommodation note.

The argument for the defendants takes the ground that to issue an accommodation note is not within the powers conferred upon the corporation; and that, as any persons taking it had notice that it was the note of the corporation, they had notice that it was of no validity unless issued for a purpose within the scope of the corporate powers, and were therefore bound to ascertain not only that it was executed by the officer of the corporation who had the general authority to sign the notes which they might lawfully make, but that the purpose for which it was issued was such as the charter authorized them to entertain and execute.

The court are all of opinion that this position is not tenable, and that the defense cannot be maintained.

It has long been settled in this Commonwealth that a manufacturing corporation has the power to make a negotiable promissory note.

Narragansett Bank v. *Atlantic Silk Co.*, 3 Met. 282. And it was held in *Bird* v. *Daggett*, 97 Mass. 494, as a just corollary to that proposition, that such a note in the hands of a holder in good faith for value is binding upon the maker, although made as an accommodation note. The question was not discussed, nor the reasons for the decision fully stated, in *Bird* v. *Daggett;* but it was assumed that the doctrine announced was clear and undoubted law.

The doctrine of *ultra vires* has been carried much farther in England than the courts in this country have been disposed to extend it; but, with just limitations the principle cannot be questioned, that the limitations to the authority, powers, and liability of a corporation are to be found in the act creating it. And it no doubt follows, as claimed by the learned counsel for the defendants, that when powers are conferred and defined by statute, everyone dealing with the corporation is presumed to know the extent of those powers.

But when the transaction is not the exercise of a power not conferred on a corporation, but the abuse of a general power in a particular instance, the abuse not being known to the other contracting party, the doctrine of *ultra vires* does not apply. As was said by SELDEN, J. in *Bissell* v. *Michigan Southern and Northern Indiana Railroad Co.*, 22 N.Y. 289, 290:

> There are no doubt cases in which a corporation would be estopped from setting up this defense, although its contract might have been really unauthorized. It would not be available in a suit brought by a bona fide indorsee of a negotiable promissory note, provided the corporation was authorized to give notes for any purpose; and the reason is, that the corporation, by giving the note has virtually represented that it was given for some legitimate purpose, and the indorsee could not be presumed to know the contrary. The note, however, if given by a corporation absolutely prohibited by its charter from giving notes at all, would be avoidable not only in the hands of the original payee, but in those of any subsequent holder; because all persons dealing with a corporation are bound to take notice of the extent of its chartered powers. The same principle is applicable to contracts not negotiable. When the want of power is apparent upon comparing the act done with the terms of the charter, the party dealing with the corporation is presumed to have knowledge of the defect, and the defense of *ultra vires* is available against him. But such a defense would not be permitted to prevail against a party who cannot be presumed to have had any knowledge of the want of authority to make the contract. Hence, if the question of power depends not merely upon the law under which the corporation acts, but upon the existence of certain extrinsic facts, resting

peculiarly within the knowledge of the corporate officers, then the corporation would be estopped from denying that which, by assuming to make the contract, it had virtually affirmed.

This doctrine seems to us sound and reasonable; and in conformity with it, it was held in *Farmers' & Mechanics' Bank* v. *Empire Stone Dressing Co.*, 5 Bosw. 175, that an accommodation acceptance by an officer of a manufacturing corporation, on behalf of the company was not binding, unless the consideration had been advanced upon the faith of the acceptance; but that if the consideration was paid in good faith after the acceptance, and upon the credit of it, it could be enforced.

So it was said by LORD ST. LEONARDS, that he felt a disposition "to restrain the doctrine of *ultra vires* to clear cases of excess of power, with the knowledge of the other party, express or implied from the nature of the corporation, and of the contract entered into." *Eastern Counties Railway Co.* v. *Hawkes*, 5 H.L. Cas. 331, 373.

The cases on which the defendants rely are cases against municipal corporations, in respect to which the rule is much more rigid, or for the most part those in which the other contracting party had notice upon the face of the transaction of the want of corporate power.

There can be no doubt that it is very often true that a corporation may be responsible for the unauthorized, and even for the unlawful acts of its agents, apparently clothed with its authority. No corporation is empowered by its charter to commit an assault and battery; yet it has frequently been held accountable in this Commonwealth for one committed by its servants. Bills of a bank issued without consideration, and even stolen, are good in the hands of an innocent holder for value. Many other illustrations might be given, but enough has been said to show the principle on which our decision rests.

Judgment for the plaintiffs.

QUESTIONS

1. The D Company was incorporated with the power to carry on a manufacturing business. Its charter does not expressly authorize it to borrow money. Is the power to borrow implied? If implied, in what way or ways may the corporation proceed to borrow money?
2. The D Company signs a promissory note for the accommodation of P, a stockholder in the corporation. P indorses the note to H, who knows that it was given by the corporation without consideration. What decision in an action by H against the corporation on the instrument?

3. In the foregoing case, H indorses the instrument to B, who pays value for it before maturity and without notice of its character as between the corporation and P. What are the rights of B on the note?
4. The charter of the corporation authorizes it to issue negotiable paper only on an express vote of the stockholders. The directors, without consulting the stockholders, executed a promissory note in the name of the corporation to P, who transferred it to H, a holder in due course. What are H's rights on the instrument?
5. Does a corporation have implied power to make a loan of money? If so, under what circumstances and to what extent?

CHICAGO, PEKIN AND SOUTHWESTERN RAILROAD COMPANY *v.* MARSEILLES

84 Illinois Reports 643 (1877)

PER CURIAM. On considering the petition heretofore filed, we granted a rehearing to further consider the question, whether the railroad company had the power to contract for and purchase shares of stock of its own company. We have again fully examined the question, and, after considering the arguments and authorities bearing on the question, we will proceed to announce our conclusions thus reached.

The rule is familiar, and it is not contested, that such bodies can only exercise such powers as may be conferred by the legislative body creating them, either in express terms or by necessary implication; and the implied powers are presumed to exist to enable such bodies to carry out the express powers granted, and to accomplish the purposes of their creation. Such being the rule, the question arises, whether this corporate body might make such a purchase, or is it outside of, and beyond, the limit of its power?

Appellant has referred us to a number of cases in our own court, in which it has been held that such organizations have no power to release subscribers for their stock from paying therefor and from their subscriptions; that, when such subscriptions are intended to be fictitious or the subscribers are released from payment, it operates as a wrong, if not a fraud, on the other subscribers for stock in the same company. But here, the stock had been subscribed, paid for, and certificates thereof issued to, and they were owned and held by, the village at the time this contract was entered into and executed. So, the question is not, whether appellant may release the village from

paying for and receiving shares subscribed for, but whether appellant has power to purchase shares of its own stock, paid for, issued to, and held by the village.

In the case of *Taylor* v. *Miami Exportation Co.*, 6 Ohio (Hammond's R.), 83, it was held that a banking corporation might lawfully receive shares of its own stock from a solvent debtor and in discharge of his indebtedness. The court went further, and held that where a large number of shares had been issued to enable the holder to vote for certain persons for directors at an approaching election, and, after the holder had thus voted, the money paid for the shares was returned to him, and he restored the shares to the bank, as there was no loss sustained by the transaction, and the result of the election was not changed, and while the court condemned the transaction, it held that equity could afford no relief, as no one had been injured. It was also held in that case that, where the shares of the company were transferred to it in payment of such indebtedness, the corporation might hold and sell it as it did its other property.

In the case of the *City Bank of Columbus* v. *Bruce*, 17 N.Y. 507, it appeared that the board of directors passed a resolution that all stockholders indebted to the bank on stock notes, by a specified day, might pay such debts to the bank in its shares of stock, at a named per cent, and that not far from half the stock of the bank was thus surrendered; and the court held, that there was no ground for questioning the validity of the transaction; that no rule of common law or any provision of the charter forbade it; and the Ohio case is referred to and approved by the court.

In the case of *Williams* v. *The Savage Manufacturing Co.* 3 Md. Ch. R. 452, it was held, that the banking corporation had the right to take shares of their own stock in pledge or payment of indebtedness to the corporation, and to reissue the same. On the latter proposition, *Ex parte Holmes*, 5 Cow. 426, is referred to by the court in its support.

In the case of the *State* v. *Smith*, 48 Vt. R. 266, it was held, that where a railroad company had purchased 2,350 shares of the stock of the company, the stock did not merge, and the legality of the purchase seems to be recognized by the court. And in further support of the rule, see Angell and Ames on *Corporation*, section 280, where it is said it is one of the corporate powers that may be legally exercised.

If then, as in the cases above referred to, a bank may purchase and hold its own shares, no reason is perceived why a railroad corporation may not do the same thing and the case of the *State* v. *Smith*,

supra, was, the purchase of stock by a railroad company, and of shares of its own stock. These authorities, we think, fully recognize the power of the directors of a company, when not prohibited by their charter, to purchase shares of stock of their company. It falls within the scope of the power of the directors to manage and control the affairs and property of the company for the best interests of the stockholders, and when they have thus acted, we will presume, until the contrary is shown, that the purchase was for legitimate and authorized purposes.

If it were shown that the purchase was made to promote the interests of the officers of the company alone, and not of the stockholders generally, or if for the benefit of a portion of the stockholders and not all, or for the injury of all or only a portion of them, or if operated to the injury of creditors, or would defeat the end for which the body was created, or if it was done for any other fraudulent purpose, then chancery could interfere. In such case, *Melvin* v. *The Lemar Insurance Co.*, 80 Ill. 446, and other cases in chancery referred to in appellant's brief would apply, but the defense cannot be made at law. The case of *Belford Railroad Co.* v. *Bower*, 48 Pa. St. R. 29, was in a court where there is no distinction between actions at law and suits in equity, and we presume the defense was allowed by the application of equitable principles, and the cases in the British courts which seem to bear on the question were in equity. Whatever may be the rights of stockholders, or creditors, if there are any, relief can only be made in equity, and by a stockholder or other *cestui que trust*.

The judgment of the court below will, therefore, be affirmed.

Judgment affirmed.

QUESTIONS

1. What is meant when it is said that a corporation buys its own stock? How can a corporation buy its own stock?
2. What parties may object to a purchase of its own stock by a corporation?
3. It is sometimes said that a corporation can buy its stock provided such a transaction is not a fraud upon creditors. How can the purchase of its stock by a corporation be a fraud on creditors?
4. A corporation buys its own stock, (*a*) for the purpose of reselling it at a profit; (*b*) for the purpose of retiring it. Discuss the validity of each transaction.
5. S appears on the books of the corporation as owner of ten shares of stock but refuses to pay for it. In what way may the corporation enforce payment of the obligation?

FRANKLIN BANK *v.* COMMERCIAL BANK

36 Ohio State Reports 350 (1881)

BOYNTON, J. We are met at the threshold of the case with the inquiry, whether an action will lie in favor of the plaintiff against the defendant for refusing to transfer, on the books of the defendant, to the name of the plaintiff, the two hundred shares of the capital stock of the defendant, represented by the certificate issued to Foote, and by him pledged to the plaintiff as security for the loan obtained. Such refusal to so transfer said stock, and an alleged consequent conversion of the same by the defendant, constitute the gravamen of the plaintiff's action.

The twelfth section of the act under which the two corporations were organized and from which they derived their powers, expressly provided, that no banking company organized under its provisions should be the holder or purchaser of any portion of its capital stock or of the capital stock of any other incorporated company, unless such purchase should be necessary to prevent loss upon a debt previously contracted in good faith, on security which, at the time, was deemed adequate to insure the payment of such debt, independent of any lien upon such stock. 1 S. & C. 170, section 12. And by section 29 it was provided, that all the rights, privileges, and franchises which the company derived from the act should be forfeited, if the directors of the company should knowingly violate, or permit the directors of the company to violate, any of the provisions of the act. That the stock in the present case was pledged or received to secure a precedent loan is not claimed.

There would seem to be little doubt, either upon principle or authority, and independently of express statutory prohibition of the same, that one corporation cannot become the owner of any portion of the capital stock of another corporation, unless authority to become such is clearly conferred by the statute. *Mutual Savings Bank* v. *Meriden Agency*, 24 Conn. 159; *Franklin Company* v. *Lewiston Savings Bank*, 68 Me. 43; *Central Railroad Co.* v. *Collins*, 40 Ga. 582. Were this not so, one corporation, by buying up the majority of the shares of the stock of another, could take the entire management of its business, however foreign such business might be to that which the corporation so purchasing said shares was created to carry on. A banking corporation could become the operator of a railroad, or carry on the business of manufacturing, and any other corporation

could engage in banking by obtaining the control of the bank's stock. Nor would this result follow any less certainly, if the shares of stock were received in pledge only, to secure the payment of a debt, provided the shares were transferred on the books of the company to the name of the pledgee. A person in whose name the stock of the corporation stands on the books of the corporation, is, as to the corporation, a stockholder, and has the right to vote upon the stock. *State* v. *White*, 42 Conn. 560; *Hoppin* v. *Buffum*, 9 R.I. 513.

Hence, if the plaintiff appeared on the books of the defendant as transferee or owner of the two hundred shares of stock represented by the certificate to Foote, it would have the right to vote upon the stock at all meetings of the stockholders of the defendant; and it would only be necessary for it to procure in pledge, as security for money loaned, a majority of the shares of the capital stock of the Commercial Bank, in order to obtain full control of its affairs, and take charge of its banking operations. This would not only be exercising powers granted to the plaintiff neither expressly nor by implication, but those which are clearly opposed to the manifest spirit and intent, if not to the language, of the statute. This court has uniformly adhered to the doctrine announced in *Straus* v. *Eagle Insurance Co.*, 5 Ohio St. 59, that corporations have such powers, and such only, as the act creating them confers; and are confined to the exercise of those expressly granted, and such incidental powers as are necessary to carry into effect those specifically conferred.

QUESTIONS

1. What objections are there to a purchase by a corporation of stock of another corporation?
2. The D Company, a manufacturing corporation, received from S ten shares of stock of the X Company in payment of a debt which S owed the D Company. Discuss the legality of the transaction.
3. The P Company is a corporation engaged in commercial banking. It makes a loan of $500 to D and receives from him ten shares of stock of a manufacturing corporation as security. S, a stockholder in the P Company, asks that the corporation be enjoined from foreclosing its lien upon the stock. What decision?
4. What is a holding company? Where does it get the power to hold stock in other corporations? What is the purpose of a holding company?
5. Four corporations, engaged in manufacturing cotton seed oil, entered into an arrangement by which they were to carry on a joint business. They agreed to select a committee, composed of representatives from

each corporation, and to turn over to this committee the properties and machinery of each mill, to be managed and operated by the committee, through officers and agents selected by them, for the common benefit; they agreed further to share profits and losses equally. S, a stockholder in one of the corporations, contends that the contract is *ultra vires* and asks that his corporation be enjoined from entering into the joint undertaking. What decision?

b) Effect of Exceeding Powers

LONG *v.* GEORGIA PACIFIC RAILWAY COMPANY

91 Alabama Reports 519 (1890)

McClellan, J. The case made by the amended bill is this: On April 23, 1883, the complainant, B. M. Long, and his wife, Amanda C. Long, executed to the Georgia Pacific Railway Co. a deed, upon valuable consideration presently paid, to and of the iron, coal, and oil interests and properties in and pertaining to certain tracts of land, aggregating about 4,000 acres, the said Long retaining the fee of said lands, except in respect to said mineral interests, and continuing in possession thereof. The grantee is a corporation, and was and is without power to purchase and hold said land, or the mineral interests in the same. The bill seeks to have the deed declared void because of the incapacity of the corporation, and to have the same canceled as a cloud upon complainant's title. The bill was demurred to on several grounds, and the demurrer was sustained generally, the decree to that end being now assigned as error.

Only those grounds of error which present the question, whether a vendor who has sold, received payment for, and conveyed land to a corporation, which had no power to hold the same, can have any relief in respect to the transaction, are discussed in argument, and to these our consideration will be confined; since it is manifest that the determination of this question in line with the decree below, as we think it must be determined, will be fatal, not only to the present appeal, but to complainant's cause of action.

It is a thoroughly well-settled law that a party to an *ultra vires* executory contract, made with a corporation, is not estopped to set up the want of corporate capacity in the premises either by the fact of contracting, whereby the power to contract is in a sense admitted or recognized, or by the fact that the fruit of issues of the contract have been received and enjoyed; and this, though the assault upon the trans-

action comes from the corporation itself. *Bank* v. *Durkin*, 54 Ala. 471; *Chambers* v. *Falkner*, 65 Ala. 448; *Sherwood* v. *Alvis*, 83 Ala. 115, 3 South. 307, 3 Am. St. Rep. 695; *Lime Works* v. *Dismukes*, 87 Ala. 344; 6 South. 122, 5 L.R.A. 100.

But where the contract is fully executed, where whatever was contracted to be done on either hand has been done, a different rule prevails. In such case the law will not interfere, at the instance of either party, to undo that which it was originally unlawful to do, and to the doing of which, so long as the contract to that end remained executory, neither party could have coerced the other. As declared by Mr. Bishop, "the parties' voluntary doing of what they had unlawfully agreed places them in effect, in the same position as if the contract had been originally good; neither can recover of the other what was parted with; the reason for which is that, since they are equally in fault, the law will help neither." Bish. *Cont.*, section 627.

The former decisions of this court are in line with this doctrine, and fully recognize the distinction between executory and executed void contracts, to the effect that, while suits to enforce the former may always be defended on the ground of their invalidity, no relief prayed upon such ground can be granted with respect to the latter. And this is the doctrine generally declared by other courts. *Thomas* v. *Railroad Co.*, 101 U.S. 71, *Day* v. *Buggy Co.*, 57 Mich. 146, *Parish* v. *Wheeler*, 22 N.Y. 494.

There is no question that the case presented by the bill involved a contract on the part of the railway company to buy, and on the part of the complainant to sell, certain interests in the land described. It is equally clear that the payment of the agreed price on the one hand, and the execution of the conveyance on the other, fully executed this contract on both sides, left nothing to be done by either party in the premises, and brings the transaction within the principle we have been considering, which denies to complainant any relief in respect to it.

The same conclusion is reached by another well-established principle. It is that when a party sells and conveys property to a corporation, which is without power to purchase and hold the same, and receives compensation therefor, there being no fraud in the transaction, he is in no sense injured or prejudiced by the incapacity of the corporation nor can he be heard to complain of it; but the question beomes one between the corporation and the state, the sovereign alone having the right to impeach the transaction; and,

until it supervenes for this purpose the corporation is vested with perfect title against all the world defeasible only on office found. *Railroad Co.* v. *Proctor*, 29 Vt. 93; *Leasure* v. *Millegas*, 7 Serg. & R. (Pa.) 313; *Goundie* v. *Water Co.*, 7 Pa. 233; *Baird* v. *Bank*, 11 Serg. & R. (Pa.) 411; *Lathrop* v. *Bank*, 8 Dana (Ky.) 114, 129, 33 Am. Dec. 481; *Hough* v. *Land Co.* 73 Ill. 23, 23 Am. Rep. 230; *Cowell* v. *Springs Co.*, 100 U.S. 55, 25 L. Ed. 547; *Reynolds* v. *Bank*, 112 U.S. 405, 413, 5 Sup. Ct. 213, 28 L. Ed. 733; 2 Morawetz, *Private Corporations*, section 710.

The decree of the chancellor is affirmed.

QUESTIONS

1. What persons are in a position to object to *ultra vires* transactions on the part of a corporation?
2. In what possible ways might an *ultra vires* transaction of a corporation be treated? How should it be treated?
3. Did the court in the principal case decide that title to the mineral rights passed to the Georgia Pacific Railway Co.? Or did the court merely decide that it would grant no relief to complainant because the transaction was executed?
4. The D Railway Company is empowered to acquire and hold land for railway purposes. It purchases and pays for a tract of land which it intends to hold for speculative purposes. The seller tenders the money back to the corporation and sues for the return of the property on the ground that the corporation had no power to buy it. What decision?
5. The A Company was incorporated "for the promotion of art and art education" and empowered to "acquire and hold real and personal estate to an amount not exceeding $1,500,000." It had property worth about $1,000,000. X conveyed by way of a gift conveyed to the corporation land worth about $2,000,000. What is the effect of the deed?

WHITNEY ARMS COMPANY *v.* BARLOW

63 New York Reports 62 (1875)

The plaintiff is a corporation organized in the state of Connecticut, as declared by its charter, for the purpose of manufacturing every variety of firearms, and other implements of war. This action was brought against the defendants as trustees of the American Seal Lock Co., a corporation organized under the General Manufacturing Act (chap. 40, Laws of 1848), to enforce the statutory liability to pay

the debts of said corporation because of an alleged failure to make, publish, and file annual reports.

Said corporation was organized in May, 1871. Its capital stock was $300,000 all of which was issued to pay for certain patent rights purchased by the company. No report was made and filed until January 19, 1872, when a report was made, verified, and filed containing the following statement:

"The amount of the capital stock of this company, and which has been issued for the purchase of patent rights and which has not been paid in cash, is $300,000; amount of existing debts, $45,383.88."

A report, similar to the statement of capital stock, was filed January 18, 1873. On October 6, 1871, said corporation entered into a contract with plaintiff by which the latter agreed to manufacture and deliver 20,000 railroad locks to be paid for sixty days after delivery. Plaintiff made and delivered 10,000 locks under the contract when, by mutual agreement, the contract was suspended as to the residue. The evidence as to the time of delivery was conflicting and uncertain, but the balance of testimony was to the effect that a few were delivered in December, 1871; the greater portion in January, and a few in February, 1872. Two notes were given by defendant's company for the purchase price at two months, one dated January 24, 1872, the other January 31, 1872.

The court directed a verdict for the plaintiff for the amount of the indebtedness, which was rendered accordingly.

ALLEN, J. [After discussing the sufficiency of the reports filed by the defendant company, the court proceeds]: As it is left in doubt whether some portion of the debt did not accrue during the default of 1871, and as other questions may arise, it is necessary to consider the other objections taken by the appellant to the judgment.

It must be conceded that the manufacturing and vending of "railroad locks" is not within the purpose for which the plaintiff was incorporated, or within the powers conferred by its charter. Neither is such business incidental to the purposes of the incorporation, or in any way necessary to, or as far as appears even an aid in, the exercise of the powers conferred upon the plaintiff by its constitution, so that it could be regarded as among the implied powers granted by the legislature and assumed by the corporators.

Did the question now made arise upon an application by the stockholders and corporators to restrain the corporate agents from applying the corporate funds to purposes foreign to the corporation

or engaging in business outside of that for which the company was formed, or on proceedings by the sovereign power to annul the charter for an abuse of the powers granted, or in a proceeding to enforce and for the performance of an executory contract, where, upon a rescission or annulling of the agreement, both parties would have the same position as if no contract had been made, the rules of decision would be different from those which must prevail in the present action. In either of the cases suggested it is very likely the courts would be compelled to give full effect to the objection and hold the business unauthorized and a violation of the charter, and a forfeiture of the chartered rights and the contract null, and refuse to perform it or give effect to it. The manufacture of the locks, or contract to sell them to the Seal Lock Co., were not acts immoral in themselves or forbidden by any statute, neither *mala in sese* or *mala prohibita*, so as to make the contract illegal and incapable of being the foundation of an action; such a contract as the law will not recognize or enforce, but applying the maxim, *ex facto illicito non oritur actio*, leaves the parties as it finds them.

When acts of corporations are spoken of as *ultra vires*, it is not intended that they are unlawful or even such as the corporation cannot perform, but merely those which are not within the powers conferred upon the corporation by the act of its creation, and are inferred upon the corporation by the acts of its creation, and are in violation of the trust reposed in the managing board by the shareholders, that the affairs shall be managed and the funds applied solely for carrying out the objects for which the corporation was created. *Earl of Shrewsbury* v. *North Staffordshire Railway Co.*, L.R. 1 Eq. 593; *Taylor* v. *Chichester & Midhurst Railway Co.*, L.R., 2 Exch. 356; *Bissell* v. *Mich. C. R. Co.*, 22 N.Y. 258.

Whether the contract as originally made was *ultra vires* is not a very important inquiry at this time. If it was, the state under whose sovereignty it dwells and by whose act and favor it exists, has no interest in arresting its action for the recovery of moneys equitably due upon a contract fully executed and a work fully accomplished, whatever may be its right to annul its charter. The shareholders whose confidence has been abused and whose funds have been diverted from their proper use, have a direct interest in reclaiming and restoring to proper custody and applying to legitimate uses the funds which have been diverted and improperly used for purposes *dehors* the legitimate business of the corporation. The plea of *ultra vires* should

not as a general rule prevail, whether interposed for or against a corporation, when it would not advance justice, but on the contrary would accomplish a legal wrong.

Here as between two corporations, the debtor and creditor corporation, the contract has been fully performed by the creditor, the plaintiff in this action, and the Seal Lock Co. has received the full consideration of its promise to pay. The plaintiff has parted with its property to the latter corporation, and unless a legal liability exists on the part of the latter to pay, the plaintiff can neither reclaim the property nor recover compensation, and under this technical plea a great wrong will be perpetuated. A purchaser who acquires by contract, and under an agreement to pay for it, the property of a corporation cannot defeat the claim for the purchase price by impeaching the right of the corporation to become the owner of the property. One who has received from a corporation the full consideration of his engagement to pay money either in services or in property, cannot avail himself of the objection that the contract thus fully performed by the corporation was *ultra vires*, or not within its chartered privileges and powers. It would be contrary to the first principles of equity to allow such a defense to prevail in an action by the corporation.

It is now very well settled that a corporation cannot avail itself of the defense of *ultra vires* when the contract has been in good faith fully performed by the other party, and the corporation has had the full benefit of the performance and of the contract. If an action cannot be brought directly upon the agreement either equity will grant relief or an action in some other form will prevail. The same rule holds *e converso*. If the other party has had the benefit of the contract fully performed by the corporation, he will not be heard to object that the contract and performance were not within the legitimate powers of the corporation.

The only justification for such a plea by an individual sued upon a contract with a corporation is that the obligation is not mutual, as the other party, the corporation, would not be bound by it. The objection to such a defense in an action upon an executed contract is given by TINDAL, C. J., in these words:

> Upon the general ground of reason and justice, no such answer can be set up. The defendants having had the benefit of the performance by the corporation of the several stipulations into which they entered, have received the consideration of their own promises; such promise by them is

therefore not *nudum pactum;* they never can want to sue the corporation upon the contract in order to enforce the performance of their stipulations which have been already voluntarily performed, and therefore no sound reason can be suggested why they should justify their refusal to perform the stipulations made by them on the ground of inability of the corporation, which suit they can never want to sustain.

In *Jones* v. *Barlow*, 62 N.Y. 302, we held that the liability of a trustee, upon the failure of the corporation to make the annual report called for by the statute, was coextensive and concurrent with that of the corporation *quoad* the debt which was sought to be fixed upon him. That there must be not only an existing debt against the corporation but a debt presently due and for the recovery of which an action would lie against the corporation; and that if the corporation was not suable by reason of a novation or renewal of the debt, an action would not lie against the trustee. We gave the defendant the benefit of that rule. Applying the same principles here, and for the reasons assigned in the prevailing opinion there given, we are constrained to hold that if a valid debt exists against the corporation, to which there is no good defense in law or equity in behalf of the corporation, it must be adjudged and held a valid debt where the trustee is sought to be charged with its payment. This necessarily follows the converse of the decision in *Jones* v. *Barlow*, 62 N.Y. 202.

The first step is taken in establishing the liability of the trustees where the facts proved would entitle the plaintiff to a judgment against the corporation for the debt in suit. That establishes the existence of a debt against the corporation; and upon proofs of the other facts, viz., the trusteeship and default in making the report, the liability of the trustee is proved and judgment must go against him. Other questions may arise in respect to the report of 1873, and we do not pass upon that.

The judgment must be reversed and a new trial granted, costs to abide event. All concur.

Judgment reversed.

QUESTIONS

1. Why was the action in this case brought against the defendants? Why was it not brought against their corporation?
2. The court said that the contract in this case was *ultra vires* and yet said that the plaintiff could enforce it. Upon what theory does the court base this decision?

3. Suppose in the principal case that the Whitney Arms Co. had received payment from the Seal Lock Co. for the railroad locks but that it had refused to deliver any railroad locks to the latter company, what would have been the rights of the Seal Lock Co. against the Whitney Arms Co.?
4. The D Company in excess of its powers contracts to buy land from P. (*a*) P sues the D Company for its refusal to accept and pay for the land. (*b*) The D Company sues P for his refusal to sell the land. What decision under each hypothesis?
5. The D Railway Company contracted to buy 10,000 steel rails from P. The D Company did not need the rails for corporate purposes but contracted for them to resell at a profit. P sued the D Company for its refusal to accept and pay for the rails. The company contended that the contract was illegal because it had no power to buy steel rails for speculative purposes. What decision?

MALLORY *v.* HANAUR OIL WORKS

86 Tennessee Reports 598 (1888)

Action of unlawful detainer by the Hanaur Oil Works against the defendant to recover possession of property surrendered to the defendants under a combination or partnership agreement.[1]

LURTON, J. It is next argued that if the contract be *ultra vires*, that it is an executed contract, and that the courts will not in such case interfere. This contract had yet a little over a year to run. The possession of the Hanaur mills had been obtained under it, and was withheld under a claim of right by reason of the supposed validity of the partnership.

As to the unexpired time, during which the defendants in error might be deprived of the use of their property, and subjected to the hazards of another year's operations, it was not an executed contract. The possession obtained under this contract was illegal, and it was the duty of the officers of the Hanaur Company to renounce the arrangement and recover the possession. There are cases where, an invalid contract being fully executed, the courts will not entertain a suit to recover money or property transferred under such agreement, or, if they do interfere, will do so only upon equitable terms. But the defense here made would result, if successful, in enforcing the performance of the unexecuted part of a void contract. It is not a case of contract fully executed. The part remaining to be executed

[1] In an omitted part of the opinion the court held that a contract of partnership between Hanaur Oil Works and three other corporations was *ultra vires*.

is a material part, and is beyond the power of defendant in error to make or sanction. Having entered into it, it was its duty to rescind or abandon it.

In a case where a lease had been made, by a railway company for a term of twenty years of its road and franchises, and which, after a lapse of five years, it rescinded, and was thereupon sued for damages under a clause in the lease which authorized rescission, and provided for compensation for unexpired term, the Supreme Court of the United States said:

> It is not a case of contract fully executed. The very nature of the suit is to recover damages for non-performance As to this it is not an executed contract. Not only so, but it is a contract forbidden by public policy, and beyond the power of defendant to make. Having entered into the agreement, it was the duty of the company to rescind or abandon it at the earliest moment. This duty was independent of the clause which gave them the right to do it. Though they delayed its performance several years, it was nevertheless a rightful act when done. Can this performance of a legal duty—a duty both to stockholders and the public—give to plaintiffs a right of action? Can they found such a right on an agreement void for want of corporate authority and forbidden by the policy of the law? To hold that they can, is, in our opinion, to hold that any act performed in executing a void contract makes all its parts valid, and that the more that is done under a contract forbidden by law the stronger is the claim to its enforcement by the courts. [*Thomas* v. *Railroad Co.*, 101 U.S. 86, 25 L. Ed. 950.]

That the defendant in error has submitted to a void contract by which it has been deprived of the use of its property for two years, furnishes no sound reason why it shall submit for three years. To hold that it did would be to apply the doctrine of part performance in a way to perfect and legalize illegal contracts which were partly performed. We have not deemed it necessary to consider the question of the legality of such a combination or corporations as one tending to create a monopoly, for the ground upon which we place the case needs no additional prop. The question of the validity of such an agreement is a very grave one, but need not now be considered.

The suggestion that, if this contract was void, yet nevertheless it operated to convert the managers of the combination into tenants from year to year, and that tenancy could be terminated only at the end of a year, and upon six months' notice, is not tenable. The relation of landlord and tenant never existed under the contract if

it be considered as valid, and could not spring from its illegality. The Hanaur Mill Co. had a right to repudiate the arrangement at any time and it was the duty of plaintiffs in error to have at once surrendered possession. The service of a writ in a suit of unlawful detainer was the only notice they could legally demand. When the action of unlawful detainer will lie under our statutes, no other notice than the suing out of a writ is necessary. Code Mill & V. 4082.

The result is that we hold that there was no error in the charge of the circuit judge, or his refusal to charge, and the judgment must be affirmed with costs.

QUESTIONS

1. Was the action in this case brought on the *ultra vires* contract? If not, what was the nature of the proceedings? On what theory was the corporation in this case permitted to get its property back?
2. The D Company, without power to do so, leased land from P for a period of years at an agreed rental of $1,000 a year. The corporation went into possession of the land but refused to pay the rent at the end of the first year. This is an action by P to have the contract declared void and to recover possession of his property. What decision?
3. In the foregoing case, P brings an action to recover the rental for the first year. What decision?
4. The P Company, without power to do so, leased corporate land to D for a period of five years at an agreed rental of $1,000. At the end of the first year the corporation brought proceedings to have the lease declared void and to recover possession of its property. What decision?
5. In the foregoing case, D refused to pay the agreed rental. The corporation brings an action for $1,000. What decision?

2. Distribution of the Powers of the Unit

a) Powers of the Majority

JOHNSTON *v.* DUTTON

27 Alabama Reports 245 (1855)

Action by Dutton's administrator against Johnston & Co. The latter firm was composed of Johnston, Fogg and Vanderslice. The notes were drawn and signed in the firm name by Fogg. They were dated December 17, 1852, and January 8, 1853. Johnston denied liability on the ground that prior to the giving of the notes he had given personal notice to Dutton and had also published a notice in the newspaper that he, Johnston, would not be bound by or for any

future contracts made by Fogg without Johnston's consent. Other facts appear in the opinion. Judgment for plaintiff and defendants appeal.

GOLDTHWAITE, J. The evidence in this case tended to show that the appellants and one Vanderslice carried on in copartnership a steam sawmill, which, by the articles of the copartnership, was to continue at least five years; that the note sued on was given with the concurrence of two of the partners, Fogg and Vanderslice, for supplies necessary for the hands engaged in carrying on the mill, which had been ordered by one of them. Upon these facts alone, there can be no doubt that the firm would be bound. The furnishing of supplies to those engaged in the immediate direction of the business was essential to the conducting of it, and within the scope of the purpose for which the individuals had associated; and the authority of either of the partners to purchase such supplies, and give the note of the firm, cannot be questioned.

The principal ground of objection, however, is, that the evidence proved that, before the goods were furnished and the note given, the appellant, Johnston, gave notice to the public that he would not be responsible for any future debt contracted on account of the copartnership, and that this notice was brought home to the party with whom the debt was contracted; and it is insisted that its effect was to revoke the authority of the other partners, so far as he was concerned, to bind the firm from that time.

It is to be observed, that in the present case the contract was concurred in by two members of the firm, and the question, therefore, is, as to the right of the majority to bind the other partners, against their dissent, as to matters appertaining to the common business, and in the absence of any stipulation conferring that power in the articles of copartnership. This question is a new one in this court, and indeed we have found no case in which it has been expressly decided. Both in England and the United States, there are cases which assert the general proposition, that a partner may protect himself against the consequences of a future contract, by giving notice of his dissent to the party with whom it is about to be made. *Gallway* v. *Matthew*, 10 East, 264; *Willis* v. *Dyson*, 1 Stark, 164; *Vice* v. *Fleming*, 1 Y. & Jerv. 227, 230; *Leavitt* v. *Peck*, 3 Conn. 125, post; *Feigley* v. *Sponeberger*, 5 W. & S. 564; *Monroe* v. *Connor*, 15 Me. 178, 32 Am. Dec. 148. And where the firm consists of but two persons and there is nothing in the articles to prevent each from having an

equal voice in the direction and control of the common business, the correctness of the proposition cannot be questioned. In such case, the duty of each partner would require him not to enter into any contract from which the other in good faith dissented; and if he did, it would be a violation of the obligations which were imposed by the nature of the partnership. It would not, in fact, be the contract of the firm; and the party with whom it was made, having notice, could not enforce it as such. So, if the firm was composed of more than two persons, and one of them dissented, the party with whom the contract was made acts at his peril, and cannot hold the dissenting partner liable, unless his liability results from the articles or from the nature of the partnership contract. All the cases can be sustained on this principle; and it is in strict analogy with the civil law, which holds where the stipulations of the partnership expressly intrust the direction and control of the business to one of the partners, that the dissent of the other would not avail, if the contract was made in good faith (Pothier, *Traite du Com. de Soc.*, No. 71, 90); and such also, we think, is the rule of the common law. *Const.* v. *Harris*, *Turn. & Russ*, 496; Story on *Partnership*, section 121. Were it otherwise, it would be denying the parties the right to make their own contracts. If our views as to the governing force of express stipulations are correct, the effect of such terms or conditions as result by clear implication from the articles, or arise out of the nature of the partnership must be the same. It is as if they had been expressly provided.

Now, whenever a partnership is formed by more than two persons, we think that in the absence of any express provision to the contrary, there is always an implied understanding that the acts of the majority are to prevail over those of the minority, as to all matters within the scope of the common business; and such we understand to be the doctrine asserted by Lord Eldon in *Const.* v. *Harris*, *supra*, and such was the opinion of Judge Story; Story on *Partnership*, section 123; 3 Kent's *Com.* (5th ed.) 45. The rule as thus laid down, is certainly more reasonable and just, than to allow the minority to stop the operations of the concern, against the views of the majority. We do not say that it would be a bona fide transaction, such as to bind the firm, if the majority chose wantonly to act without information to or consultation with the minority (Story on *Partnership*, sec. 123); but, when, as in the present case, the one partner has given notice, and expressed his dissent in advance, there could be no reason or propriety in requiring him to be consulted by the other two.

We do not consider the cases to which we have been referred, holding that one partner has the right at pleasure to dissolve a partnership, although the articles provide that it is to continue for a specified term (*Marquand* v. *New York Insurance Co.*, 17 Johns. 525; *Skinner* v. *Dayton*, 19 *Id.* 513, 10 Am. Dec. 286), as having any bearing on the case under consideration. Conceding they are law—which is doubtful (Story on *Partnership*, sec. 275, n. 3, and cases cited)—the decision rests solely upon the ground that the limitation on the right of dissolution is incompatible with the nature of the corpartnership contract; and this principle does not militate against the position we have asserted. The dissent, in the present case, cannot be regarded as a dissolution, for, if effectual, it would not necessarily produce that result, although it might operate to change the mode of conducting the business. In other words, it might be carried on without contracting debts.

Our conclusion is, that the act, being concurred in by two of the partners, was, under the circumstances, the act of the firm; and that the charge, asserting the proposition that the dissent of one partner against the other two would necessarily exonerate him, was properly refused.

Judgment affirmed.

QUESTIONS

1. Why was the dissent of Johnston not an act of dissolution? Even if his dissent had been construed to be a dissolution would he, nevertheless, have been liable on the notes in question?
2. In the absence of an agreement to the contrary in whom does the power to manage the affairs of the partnership rest?
3. A, B, C, D, and E are partners in the hardware business. The majority, over the objection of the minority, vote to add to the business a line of plumbing supplies which they had not hitherto carried. What are the rights, if any, of the minority?
4. The majority vote to go out of the hardware business and go into the business of selling plumbing supplies. What are the rights, if any, of the minority?
5. (*a*) The majority vote to increase the capital of the business, (*b*) to decrease the capital, (*c*) to change the name of the firm, (*d*) to change the location of the business. What are the rights, if any, of the minority under each of the foregoing hypotheses?
6. The majority vote to go out of business before the time contemplated in the articles of partnership. Can B prevent this premature dissolution? If the dissolution takes place in spite of his objection, has he any remedy?

DUDLEY *v.* KENTUCKY HIGH SCHOOL

9 Bush's Kentucky Reports 576 (1873)

LINDSAY, J. The order from which this appeal is prosecuted must be regarded as final. The special demurrer to the jurisdiction of the court was sustained, and a judgment rendered against appellant for the cost of the entire proceeding. This is equivalent to dismissing the petition for the want of jurisdiction in the court, and effectually precludes appellant from taking further steps in the litigation to obtain the relief desired.

The object of the corporation was to establish and maintain a high school, and not to make money, and it has no legal right to engage in speculations or investments in real estate for the last-named purpose; but it has the expressly delegated power "to receive and hold for the benefit of said high school any lands, tenements, etc., by gift, devise, donation, contract, or purchase." It is not complained that the house and lands purchased or about to be purchased from Gaines are not to be held for the benefit of the school, but that the corporation is unable to pay the contemplated price, and that the inevitable result of the purchase, if consummated, will be the bankruptcy of the corporation and the failure of the project to establish the school.

It is true that a majority of stockholders, no matter how great, have not the right to divert the funds of a joint-stock incorporated company to any other than the purposes for which it was organized; and if such funds are about to be so diverted, a stockholder may file a bill in equity against the company to restrain it by injunction from such diversion or misapplication. *Baghaw* v. *Eastern Counties Railway Co.*, 7 Hare, 114; 1 Beaven, 1; *March* v. *Eastern Railway Co.*, 40 N.H. 548, 77 Am. Dec. 732. But relief will not be granted unless the corporation is about to do some act outside of the scope of its authority, or in disobedience to the provisions of its constitution, for so long as it exercises the powers granted by the charter the acts of the company must be treated by the courts as the acts of all the stockholders.

Each and every stockholder contracts that the will of the majority shall govern in all matters coming within the limits of the act of incorporation; and in cases involving no breach of trust, but only error or mistake of judgment upon the part of the directors who represent the company, individual stockholders have no right to

appeal to the courts to dictate the line of policy to be pursued by the corporation. Angell and Ames on *Corporations*, section 393. Nor does the irregular manner in which the board of directors voted upon the proposition to make the purchase from Gaines authorize the chancellor to interpose to prevent its consummation. In the case of *Foss* v. *Harbottle*, 2 Hare, 461, where the object of the bill in equity was to obtain relief against what was alleged to be a fraud committed by certain of the directors in an incorporated company, which fraud consisted in the sale to themselves, as representatives of the company, of lands in which they were individually interested, VICE-CHANCELLOR VIGRAM held that although the act might be voidable by the company, yet, inasmuch as a majority of the proprietors might at a general meeting confirm, he declined to interfere, saying, "While the court may be declaring the acts complained of to be void, at the suit of the present plaintiffs, who in fact may be the only proprietors who disapprove of them, the governing body of proprietors may defeat the decree by lawfully resolving upon the confirmation of the very acts which are the subject of the suit." So in this case, while it may be that the corporation has the right to avoid the purchase from Gaines, because one of the directors, without whose vote the proposition would have been rejected, was allowed to vote by proxy, yet it may be that Dudley is the only stockholder who disapproves of the purchase, and it might result that, at the time the court was protecting him against the payment of his subscription because of the unauthorized action of the directors, a majority of the stockholders in general meeting might ratify or have already ratified the purchase, and have bound Dudley under his contract of subscription to submit to their will thus regularly and legally expressed.

It may be that the price agreed to be paid for the house and lands is greatly more than its value, but about this matter the opinion of the majority of the stockholders as expressed through the directory must control, and so far as the action of the court in this case is concerned, it is immaterial whether the corporation acted wisely or unwisely in contracting a debt which possibly it will be unable to pay. The charter empowers it to make purchases of land, to contract debts, and to issue bonds to an amount not over two-thirds of the stock subscribed; and if these powers are so exercised as to result in loss to the stockholders, it is a misfortune against which the courts can afford no protection.

Judgment affirmed.

QUESTIONS

1. The court said in this case that the will of the majority controls in the management of the corporation. What is the basis of this rule? What is the extent of the application of the rule?
2. The D Company was incorporated with power to construct and operate a railroad company. Subsequently the legislature authorized the corporation to amend its charter, authorizing it to increase its capital stock, purchase boats and engage in water transportation. The minority stockholders ask that the corporation be enjoined from accepting the amendment. What decision?
3. Would your answer be the same in the foregoing case if the corporation had been authorized to do the things complained of when the objecting stockholders came into the corporation?
4. The majority stockholders voted to accept the following amendments to the charter of the corporation which were not authorized when S became a member of the corporation: (*a*) changing the name of the corporation; (*b*) increasing the capital stock; (*c*) decreasing the capital stock; (*d*) changing the location of the business; (*e*) authorizing the issuance of preferred stock for the purpose of raising additional capital with which to carry on the business. S, representing the minority stockholders, asks that the corporation be enjoined from accepting the various amendments. What decision under each hypothesis?

CENTRAL RAILROAD COMPANY *v.* COLLINS

40 Georgia Reports 582 (1869)

This was a bill brought by the stockholders of the Central Railroad Co. and the Southwestern Railroad Co., seeking to enjoin the corporations in question from purchasing stock in the Atlantic and Gulf Railroad Co. The trial court held that neither corporation had power to acquire and hold stock of another corporation and accordingly enjoined the corporations from making the proposed purchase.

McCay, J. This is a bill filed by certain stockholders in the Central Railroad, certain stockholders in the Southwestern Railroad, and certain other persons who claim to come before the court as citizens of the state of Georgia, and as such to be interested in the relief sought by the bill.

The substance of the charges is, that the Central Railroad Co. and the Southwestern Railroad Co., the former chartered to build and maintain a railroad from Savannah to Macon, and the latter chartered to build and maintain a railroad from Macon to the Chattahoochee River, are about to purchase from the city of Savannah,

certain stock, including twelve thousand three hundred and eighty-three shares in the Atlantic and Gulf Railroad Co., a company chartered to build a railroad from Savannah to Bainbridge, with the intent and purpose on the part of these two companies to use the stock thus purchased to affect the management of the Atlantic and Gulf Road.

The answers admit, in substance, the charges; but the injunction is sought to be dissolved on the ground that there are not proper parties to the bill, and on the further ground, that said Central Railroad Co., and Southwestern Railroad Co., have a right under their charters to make such a purchase.

There are, it is true, some other points made in the demurrer and motion to dissolve, but in the view taken of the case by the majority of the court, these are the essential questions.

Upon the question of the parties, we agree that the citizens, in their character as such, are not proper parties to *this* proceeding. The state as one of the stockholders of the Atlantic and Gulf Road is a proper party; but the simple citizen, who has no other interest, has not, as it seems to us, any rights in this controversy. This is a simple attempt to enjoin the making of a certain contract, a mere private suit, in which no one has a right to be heard, that is not interested in the decree. The wrong done the public by the alleged violation of the charter cannot be reached in this proceeding except so far as it affects the interests of those whose pecuniary rights are affected by the proposed contract.

But the stockholders in the Central and Southwestern Railroad Cos., and the Atlantic and Gulf Road and its stockholders, are proper parties. The former allege that this contract is a violation of their rights under the several charters, and the latter that it is injurious to its rights that these two rival roads should be permitted to acquire so controlling an interest in the management of its road. As this ground of the motion to dissolve is in the nature of a general demurrer, to be good, it ought to show there are no proper parties to the bill.

We think the stockholders of the several roads are proper parties, have a good cause of complaint, and we therefore think the court did right to overrule the motion on this ground.

We do not think the profitableness of this contract, to the stockholders of the Central and Southwestern Railroad stockholders, has anything to do with the matter. These stockholders have a *right*, at their pleasure, to stand on their contract. If the charters do not

give to these companies the *right* to go into this new enterprise, any one stockholder has a right to object. He is not to be forced into an enterprise not included in the charter.

That it will be to his interest is no excuse; that is for him to judge. By becoming a stockholder he has contracted that a majority of the stockholders shall manage the affairs of the company within its proper sphere as a corporation, but no further; and any attempt to use the funds, or pledge the credit of the company not within the legitimate scope of the charter is a violation of the contract which the stockholders have made with each other, and of the *rights—the contract rights*—of any stockholder who chooses to say, "I am not willing." It may be that it will be to his advantage, but he may not think so, and he has a legal right to insist upon it that the company shall keep within the powers granted to it by the charter: 1 Shelford on *Railways*, 71; 1 My. & K. 162–63; 4 Y. & Coll. 618; 2 Dan. P.C. 521; 5 Hill, 386; 18 Barbour, 318; 43 N. Hamp., 525; 6 Angell and Ames on *Corporations* (4th ed.), and cases cited.

I am therefore of the opinion that the judgment of the court below, refusing to dissolve the injunction, is right and ought to be affirmed.

QUESTIONS

1. Upon what theory did the court in this case grant the relief prayed for?
2. The D Company was organized with the power to conduct a commercial and savings bank. The stockholders voted to purchase a piece of land and hold it for speculative purposes. The minority stockholders ask that the transaction be declared void and canceled. What decision?
3. The stockholders of the corporation vote to purchase stock in the X Company, a manufacturing corporation. The minority stockholders ask that the corporation be enjoined from taking the proposed action. What decision?
4. The corporation in the foregoing case makes the purchase with the assent of all stockholders. Later on S and other stockholders repent and bring a bill asking that the transaction be declared void. What decision?

PLANT *v.* MACON OIL AND ICE COMPANY

103 Georgia Reports 666 (1898)

Lewis, J. This was a petition filed by R. H. Plant and W. E. McCaw, as minority stockholders of the Macon Oil & Ice Co., a corporation, against that company, E. N. Jilks, R. J. Taylor, and the Southern Phosphate Works, for an injunction to prevent the corpora-

tion from making or carrying into effect a lease of its property and franchises, which petitioners contended was *ultra vires*.

It was contended by counsel for the plaintiffs that the enumeration of the powers granted to this corporation by the order of the judge of the superior court excluded the exercise of all powers not conferred by its charter; that the order of incorporation did not include the power to lease the entire plant of the corporation—or, in other words, to go out of business as a manufacturing concern. The general doctrine that the powers of a corporation, whether public or private, are such only as are conferred by its charter, either expressly or by fair implication, is too well settled to require discussion. The question, however, whether a private corporation, unless expressly restrained by statute, has an unlimited power of alienating or leasing its property, is one upon which the authorities do not apparently agree. A distinction must be drawn between the powers of a public corporation and those of a private corporation in this particular.

Our attention has been called to the cases of *Thomas* v. *Railroad Co.*, 101 U.S. 71, 25 L. Ed. 950, and *Pennsylvania Railway Co.* v. *St. Louis, A. & T. H. Railway Co.*, 118 U.S. 290, 6 Sup. Ct. 1094, 30 L. Ed. 83, in which that court ruled that a railroad company, unless specially authorized by its charter, or aided by some other legislative action, cannot, by lease or other contract, for a long period of time, turn over to another company it appurtenances, franchises, and powers. In Reese, *Ultra Vires*, section 137, it is stated: "This rule is based upon the theory that public or *quasi* public corporations, which possess and exercise the right of eminent domain or its equivalent, owe duties to the public as well as to their stockholders; and they cannot sell or lease their corporate powers and privileges and thereby disable themselves from performing their public duties, without legislative authority." The public, however, have no such interest in the franchise of a private corporation; and that rule cannot, with the same force, be applied to an alienation made by the latter class. Taylor, *Corporations*, section 132. In 4 *American and English Encyclopedia of Law*, page 219, is this text: "Corporations, unless expressly restrained by statute, have an unlimited power of alienation, like that of an individual; and, since the greater power includes the less, they may lease property, which is but a partial or temporary alienation." In *Treadwell* v. *Manufacturing Co.*, 7 Gray (Mass.) 393, 66 Am. Dec. 490, this right of alienation, in pursuance of the vote of a majority of the stockholders against the protest of the

minority was recognized. On page 404 of that case the court said: "But we entertain no doubt of the right of a corporation, established solely for trading and manufacturing purposes, by a vote of the majority of their stockholders, to wind up their affairs, and close their business, if, in the exercise of a sound discretion, they deem it expedient so to do. At common law, the right of corporations, acting by a majority of their stockholders, to sell their property, is absolute and is not limited as to objects, circumstances, or quantity"—citing a number of authorities.

On the other hand, respectable authority can be found denying this right of alienation to a private corporation, unless expressly conferred by its charter. Among the cases relied on by the plaintiff in support of this latter view is that of *Cass* v. *Steel Co.* (C.C.) 9 Fed. 640, in which the power of a private corporation to lease its plant was denied by the court. It appeared, however, in that case, that the board of directors exercised this power against the protest of the holders of a majority of the stock. It further does not appear in that case that there was any emergency or necessity calling for a lease of its property by the company. Reason, as well as authority, we think, will sustain the position that neither a majority of stockholders nor the directors of a corporation as such, without special authority for that purpose, can generally do an act which, to all intents and purposes, terminates the corporation; that they could not, for instance, while the company was in a prosperous condition, upon their own mere caprice, sell out the whole source of their emoluments, and abandon their enterprise, where a minority desired a prosecution of the business. Such is the effect of rulings in the cases of *Kean* v. *Johnson*, 9 N.J. Eq. 401; *Abbot* v. *Rubber Co.*, 33 Barb. (N.Y.) 578. These authorities, however, are based upon the idea of an abandonment of corporate franchises without any special necessity requiring such a course.

Upon a cursory glance at the authorities above cited, and a number of others we have investigated upon the subject, there would seem at first to be an irreconcilable conflict upon the powers and rights of a majority and minority of stockholders in a private corporation touching its authority to alienate or lease its property and franchises. But we think that nearly, if not quite, all of the authorities upon the subject can be reconciled, and that from a careful consideration of all of them together can be deduced the following principles, about which there seems to be very little, if any, conflict.

First. While a public or *quasi* public corporation cannot, without express authority, convey or lease its property and privileges, as a general rule this can be done by a private corporation.

Second. But a private corporation, limited as to duration, while doing a successful business, cannot sell out, and abandon its enterprise, over the protest of a minority of its stockholders, who have the right to insist upon a continuance of its business.

Third. While a minority of stockholders have the right recognized in the paragraph just above, it cannot compel a majority to continue indefinitely in the business of the corporation, provided a majority, in arrangements to discontinue the business, fully protects the interests of the minority by payment in full of the value of their shares, should it be demanded.

Fourth. A minority of stockholders cannot compel a corporation, against the wishes of a majority of the owners of the stock therein, to continue a business that would be unprofitable or ruinous in its results to the interests of all concerned. Hence it has been often held that an insolvent corporation has the right to make an assignment for the benefit of creditors, which right does not depend upon the assent of all its stockholders.

From these principles it follows as an inevitable conclusion that a private corporation has the right temporarily to lease or rent its property, when the purpose of such action is not an abandonment of its franchises, but to meet an urgent necessity of raising a fund, so as to enable it afterward to conduct its business profitably, and to continue the enterprise for which it was created. Especially is this the case where the managing officer of the corporation remains in charge of the property during this temporary rental. The emergency for immediately raising money to meet urgent claims against the corporation in this case was clearly shown.

The trial judge was authorized in drawing the conclusion that there was no purpose on the part of the corporation of abandoning its enterprise or franchises; that, on the contrary, this temporary rental of its property was really necessary for its protection, and to enable the company to continue its business. Its manager still remains the manager of the property during the tenancy. The rights of none interested in the company are jeopardized by this temporary arrangement. To place it in the power of a minority of stockholders, simply by refusing acquiescence, to defeat a scheme looking to the protection of the company's property, and a continuation of its enterprise,

might, under certain circumstances, clothe them with the authority of wrecking the company, and defeating the very objects of its corporate existence.

It was argued by counsel for plaintiffs in error that a right to rent for one year would necessarily imply, at the expiration of the lease, the power to continue the rental for another year, and so on indefinitely, and thus would follow the power of entirely and permanently transferring the franchises of the company into the hands of another. The reply to this is, "Sufficient unto the day is the evil thereof." Should a scheme of this sort in the future be attempted without any necessity for such alienation, the plaintiffs could doubtless then have redress of their grievances. No such case is made by this record, and what we now rule is that, under the undisputed facts of this case, the judge properly exercised his discretion in refusing the injunction.

Judgment affirmed.

QUESTIONS

1. The D Company, chartered for a period of fifty years, is a prosperous, going concern. Nevertheless the stockholders vote to go out of business at the end of twenty-five years. The minority stockholders ask that the corporation be enjoined from going out of business prematurely. What decision?
2. Would your answer in the foregoing case be the same if it had appeared that the corporation was chartered for an indefinite period?
3. The corporation has had many financial reverses and is no longer able to prosecute its business successfully. The stockholders vote to go out of business. The minority seek to enjoin the corporation from so doing. What decision?
4. The corporation is incorporated for the purpose of constructing and operating a railroad. Because of financial difficulties the stockholders vote to sell all the property and franchises of the corporation and go out of business. Discuss the legality of the action.

FARMERS' LOAN AND TRUST COMPANY *v.* NEW YORK AND NORTHERN RAILWAY COMPANY

150 New York Reports 410 (1896)

Appeal from judgment of the General Term of the Supreme Court in the second judicial department, entered June 30, 1894, which affirmed a judgment in favor of plaintiff entered upon a decision of the court on trial at Special Term.

This action was brought to foreclose a second mortgage upon the property of the New York & Northern Railway Co., made by it and given to the plaintiff as trustee to secure the payment of second-mortgage bonds issued by that company amounting to $3,200,000.

None of the original defendants interposed any defense; but on October 5, 1893, on their own motion, the appellants were made parties defendant in the action, and served an answer.

The appellants are stockholders of the New York & Northern Railway Co., representing about 20,000 shares of preferred and common stock, and appear in this action on their own behalf and also on behalf of the holders of the other shares represented by them.

As conclusions of law the court held that there was due under said mortgage for principal and interest the sum of $3,453,511.11, and that the plaintiff was entitled to a judgment of foreclosure and sale.

MARTIN, J. That the New York Central & Hudson River Railroad Co. purchased a majority of the second-mortgage bonds and a majority of the stock of the New York & Northern Railway Co. for the sole purpose of obtaining control of the property of the latter, is clearly established by the proof contained in the record. Indeed, such was the avowed purpose of its purchase. The record renders it equally clear that the New York Central & Hudson River Railroad Co. was the actual and beneficial owner of such bonds and stock for several months before the commencement of this action. They were retained in the hands of Drexel, Morgan & Co., not as owners or holders of their own right, but as agents or naked trustees for the New York Central & Hudson River Railroad, and were clearly subject to the order and control of the latter. Moreover, the request that Drexel, Morgan & Co. made to the plaintiff to commence this action was not only based upon the bonds owned by the New York Central & Hudson River Railroad Co. and others it had contracted to purchase, but the sole purpose of that request was to procure a foreclosure and thus enable the New York Central & Hudson River Railroad Co. to acquire control of the property and franchises of the New York & Northern Railway Co. for its own benefit, as set forth in the circular letter sent to the stockholders of the New York Central & Hudson River Railroad Co. The president of the latter company himself testified that that was the object and purpose which induced the sending of the notice requesting the commencement of this action. The notice given by the New York Central & Hudson River Railroad Co. to its stockholders states the fact that on March 18,

1893, agreements had already been made in respect to the purchase of a controlling interest in the New York & Northern Railway Co., subject to the approval therein asked for. The letter of Drexel, Morgan & Co. to the treasurer of the New York Central & Hudson River Railway Co., dated April 5, 1893, shows that the majority of the stock and bonds mentioned therein was held by them, subject to the order of the New York Central & Hudson River Railroad Co., and that they had received the note of that company in payment therefor. Thus, it is obvious that this action was procured to be commenced by the New York Central & Hudson River Railroad Co., while it owned a majority of the stock and bonds of the New York & Northern Railway Co., for the sole and avowed purpose of obtaining control of its property and business, regardless of the rights of the minority stockholders or the owners of the remainder of the bonds. The appellants contend that the New York Central & Hudson River Railroad Co., as such majority stockholder, also acquired the entire control of the affairs of the New York & Northern Railway Co. through its board of directors, who were willing to serve the interest of those owning a majority of the stock, as was indicated by the resignation of three of the directors, the appointment of others in their places, who were in the employ of the New York Central & Hudson River Railroad Co., to discharge the duties of such officers, and compensated for their services by the New York Central & Hudson River Railroad Co. While the proof upon that question was not perhaps conclusive, yet, the circumstances developed by the evidence plainly indicate that after it became the owner of a majority of the stock and bonds, the New York Central & Hudson River Railroad Co. dictated and governed the action of the board of directors and controlled the management of the affairs of the New York & Northern Railway Co.

The facts already referred to are strong proof that the New York Central & Hudson River Railroad Co. was in the control of the affairs of the New York & Northern Railway Co. It is hardly to be supposed that a board of directors who was not under the control of another corporation would appoint three of the friends of the president of that corporation as directors of the company, and place the officers of that company in control of its financial affairs, especially when it was the owner of competing lines of railroad. The clear and legitimate inference to be drawn from the circumstances proved in

this case is that after the New York Central & Hudson River Railroad Co. purchased a majority of the stock and bonds of the New York & Northern Railway Co., it controlled its officers and directors as fully and completely as though they had been elected by its votes. All the facts and circumstances, so far as the defendants were permitted to prove them, tend to show that such was the situation. Indeed, it is a matter of common knowledge that where the ownership of a majority of the stock of such a corporation changes, the board usually changes, unless its members are already in harmony with the policy of the purchasers.

On the trial the appellants sought to prove that after the New York Central & Hudson River Railroad Co. became the owner of such stock and bonds, and while its officers were in substantial control of the New York & Northern Railway Co., they declined to accept traffic from other roads that would have produced a fund with which to pay the interest due on the bonds in question; that the income of the road which should have been employed to pay such interest was used for other and improper purposes; and that such action caused the inability of the New York & Northern Railway Co. to pay the interest and thus cure its default. This evidence was rejected as immaterial, and the appellants duly excepted.

In determining the correctness of the rulings made by the trial court, it becomes necessary to determine incidentally whether a corporation, purchasing a majority of the stock of another competing corporation, may thus obtain control of its affairs, cause it to divert the income from its business, or to refuse business which would enable it to pay the interest for which it was in default, and then institute an action in equity to enforce its obligations for the purpose of obtaining control of its property at less than its value to the injury of the minority stockholders, and they have no remedy. Or, in other words, whether a court of equity, with those facts established, would lend its aid to such a stockholder by enforcing the mortgage and decreeing a foreclosure and sale of the mortgaged premises, at its request, in its behalf, and to accomplish such a purpose. If it would, then the rulings of the trial court were proper; if not, then the appellants were entitled to prove those facts, and it was error to reject the evidence.

In *Gamble* v. *Q. C. W. Co.* (123 N.Y. 91), in discussing a similar question, JUDGE PECKHAM, in effect, said that, although it is not every question of mere administration or of policy upon which there might

be a difference of opinion that would justify the minority in coming into a court of equity to obtain relief, yet, where the action of a majority of the stockholders of a corporation is fraudulent or oppressive to the minority shareholders, an action may be maintained by the latter, where the contemplated action of the majority is so far opposed to the interests of the corporation as to lead to a clear inference that such action is with an intent to serve some outside purpose, regardless of the consequences to the company and inconsistent with its interests.

In *Meyer* v. *Staten Island Railway Co.* (7 N.Y. St. Repr. 245) it was held that a majority of the stockholders of a corporation would not be permitted to sanction a transaction which is the outcome of a scheme, dishonest or fraudulent in its inception, and that the minority stockholders have rights which under such circumstances must be recognized; that the majority may legally control the company's business, but in assuming such control they take upon themselves the correlative duty of diligence and good faith, and that they cannot manipulate the company's business in their own interests to the injury of the minority stockholders.

In *Ervin* v. *Oregon Railway & Nav. Co.* (27 Fed. R. 630) it was held that when a number of stockholders combine to constitute themselves a majority, to control the corporation as they see fit, they become, for all practical purposes, the corporation itself, and assume the trust relation of the corporation toward its stockholders, and, if they seek to make profit out of it at the expense of those whose rights are the same as their own, they are unfaithful to the relation they have assumed, and guilty, at least, of constructive fraud which a court of equity will remedy.

In *Wright* v. *Oroville M. Co.* (40 Cal. 20) it was in substance held that in dealing with the relations between a corporation and its officers on one hand and the stockholders upon the other, in the management of the corporate affairs, courts of equity will look beyond the mere observance of the forms of law, and inquire if the authority has been in good faith exercised to promote the interests of the stockholders; and that a court of equity will, at the instance of a stockholder, control the corporation and its officers, and restrain them from doing acts even within the scope of the corporate authority, if such acts would amount to a breach of the trust upon which the authority had been conferred.

In *Meeker* v. *Winthrop Iron Co.* (17 Fed. R. 48) it was held that a majority of the holders of the capital stock of a corporation could

not, by their votes in a stockholders' meeting, lawfully authorize its officers to lease its property to themselves or to another corporation formed for the purpose and exclusively owned by them, unless such lease was made in good faith, and supported by an adequate consideration; and that in a suit, properly prosecuted, to set aside such a contract, the burden of proof of showing fairness and adequacy is upon the party or parties claiming thereunder.

"The law requires of the majority of the stockholders the utmost good faith in their control and management of the corporation as regards the minority, and in this respect the majority stand in much the same attitude towards the minority that the directors sustain towards all the stockholders. Thus, there the majority are interested in another corporation, and the two corporations have contracts between them, it is fraudulent for that majority to manage the affairs of the first corporation for the benefit of the second. A court of equity will intervene and protect the minority upon an application by the latter." (2 Cook on *Stock and Stockholders* [3d ed.], sec. 662, p. 945.) The same principle is stated in 1 Morawetz on *Private Corporations* (2d ed., sec. 529); 1 Beach on *Private Corporations* (sec. 70); 2 Bigelow on *Frauds* (sec. 645), and Beach on *Mod. Eq. Juris.* (secs. 132, 686).

While the question in some of the cases cited arose between stockholders and the directors and officers of a company who as such held a position of trust as to the former, still, where, as in this case, a majority of the stock is owned by a corporation or a combination of individuals, and it assumes the control of another company's business and affairs through its control of the officers and directors of the corporation, it would seem that for all practical purposes it becomes the corporation of which it holds a majority of stock, and assumes the same trust relation toward the minority stockholders that a corporation itself usually bears to its stockholders, and, therefore, under such circumstances, the rule stated in the Sage Case and in other similar cases applies to majority stockholders who control the affairs of the company, as well as to its directors or officers.

It is a controlling maxim that a court of equity will not aid parties in the perpetration or consummation of a fraud, nor give any assistance whereby either of the parties connected with the betrayal of a trust can derive any advantage therefrom. (*Farley* v. *St. Paul, Minneapolis & Manitoba Railway Co.*, 4 McCrary, 138.) "It is a sound principle, that he who prevents a thing being done shall not

avail himself of the non-performance he has occasioned." (*Fleming* v. *Gilbert*, 3 Johns. 528, 531; *United States* v. *Peck*, 102 U.S. 64; *Dolan* v. *Rogers*, 149 N.Y. 491.)

The principle of these authorities renders it quite obvious that a corporation, purchasing a majority of the stock of another competing one, cannot obtain control of its affairs, divert the income of its business, refuse business which would enable the defaulting company to pay its interest, and then institute an action in equity to enforce its obligations, for the avowed purpose of obtaining entire control of its property to the injury of the minority stockholders. Such a course of action is clearly opposed to the true interests of the corporation itself, plainly discloses that one thus acting was not influenced by any honest desire to secure such interests, but that its action was to serve an outside purpose, regardless of consequences to the debtor company, and in a manner inconsistent with its interest and the interest of its minority stockholders.

Hence, we are of the opinion that the court erred in rejecting as immaterial evidence offered by the appellants to show that, after the New York Central & Hudson River Railroad Co. became the owner of a majority of the stock and bonds of the New York & Northern Railway Co., and while its officers were in control of the latter corporation and its affairs, it declined to accept traffic from other roads which would have produced a fund with which to pay the interest that was due; that the income of the road, which should have been employed to pay such interest, was used for other and improper purposes, and that such action upon the part of the majority stockholders occasioned the inability of the company to pay the interest and cure the default. To the rejection of this evidence the defendants excepted. We think many of these rulings were erroneous, and that the appellants had the right to make the proof offered, so far as it related to the transaction of the business of the New York & Northern Railway Co., during the time the New York Central & Hudson River Railroad Co. owned a majority of its stock and controlled its affairs, and for the error in those rulings the judgment should be reversed.

QUESTIONS

1. D and others, stockholders in the Y Company, acquire the majority of the stock of the X Company, a corporation in competition with the Y Company. They immediately vote to dispose of all the property of the X Company. What are the rights of the minority stockholders of the X Company?

2. In the foregoing case, D and others vote to discontinue the business of the X Company because of its financial condition. The minority stockholders of the X Company seek to prevent the proposed action. What decision?
3. D and others hold the controlling interest in the B Corporation. The directors with the assent of the majority of the stockholders vote to sell a tract of land owned by the corporation to D at a great sacrifice. What are the rights of the minority stockholders of the B Corporation?
4. D offered to sell a piece of property to the corporation at an exorbitant price. The directors accepted the offer. Later, the majority stockholders ratified the action of the directors. What are the rights, if any, of the minority stockholders?

SCHWAB *v.* POTTER COMPANY

194 New York Reports 409 (1909)

VANN, J. The main question presented by this appeal is whether the proposed transaction is beyond the powers of the defendant corporation, for it is well established that in the absence of fraud or bad faith courts have nothing to do with the internal management of business corporations, provided they keep within their corporate powers. (*Gamble* v. *Queens County Water Co.*, 123 N.Y. 91; *Flynn* v. *Brooklyn City Railroad Co.*, 158 N.Y. 493, 507.) Thus we said in the case last cited:

> Whatever may lawfully be done by the directors or the stockholders, acting through majorities prescribed by law, must of necessity be submitted to by the minority, for corporations can be conducted upon no other basis. All the questions within the scope of the corporate powers which relate to the policy of the administration, to the expediency of proposed measures, or to the consideration of contracts, provided it is not so grossly inadequate as to be evidence of fraud, are beyond the province of the courts. The minority directors or stockholders cannot come into court upon allegations of a want of judgment or lack of efficiency on the part of the majority and change the course of administration. Corporate elections furnish the only remedy for internal dissensions, as the majority must rule so long as it keeps within the powers conferred by the charter.

The complaint does not disclose the purposes for which the defendant corporation was organized, nor set forth its corporate powers except as it may be inferred from the statement of assets and liabilities that it carries on a manufacturing business, while the new corporation apparently was to be a "realty" company. If, however,

no corporation in this state is authorized to organize another, divide its assets with it and take in exchange its entire capital stock, then the proposed plan is *ultra vires* and the execution thereof may be restrained by an injunction.

Corporations are created by statute and have no powers except those conferred by statute, directly or indirectly. (Laws, 1892, chap. 687; Laws, 1895, chap. 672, sec. 10.) There is no statute in this state which directly authorizes one corporation to organize another and, as we think, such action is not indirectly authorized by any reasonable inference from the most extensive powers committed to any class of corporations known to our law. Corporations are organized by natural persons, acting under the direction of a statute, and they only can become corporators, directors, or officers. "Artificial persons," without brain or body, existing only on paper through legislative command and incapable of thought or action except through natural persons, cannot create other "artificial persons," and those, others still, until the line is so extended and the capital stock so duplicated and reduplicated, as to result in confusion and fraud. If, in the case before us, the proposed plan is carried into effect, the old corporation will be the only stockholder of the new corporation when it comes into being, which is the time to test its legality, and the entire capital stock of the latter will have been taken from the assets of the former. After the old corporation has thus split itself into two corporations, both together will have only the capital that the old corporation had before. Not a dollar of new capital will have been contributed either in money or property and only when the old corporation sells to subscribers or outsiders—and it is not alleged that it will be able to sell to either—all or a part of the shares of stock, issued to it by the new, can any money come from the transaction. This shows that the purpose of the strange action proposed is to increase the capital stock of the old company without complying with the provisions of the statute governing the subject. The increase is to be obtained by what is in effect a forced assessment upon the fully paid and non-assessable shares of the stockholders, for unless they take new stock they lose a material part of their investment, although something they do not want is given in exchange. Thus they are virtually compelled by an unlawful scheme to enter into new contractual relations with strange parties. (*Mason* v. *Pewabic Mining Co.*, 133 U.S. 50.) This would be an obvious evasion of the law which the courts will restrain when applied to by the proper

party. As was well said by the presiding justice below in a useful opinion:

> But it is evident from the allegations of this complaint and from the inferences that fairly may be drawn from such allegations that what was in the contemplation of the directors and majority stockholders of the defendant corporation was not to have that corporation make an actual sale of the real estate to another corporation and receive shares of stock as the consideration therefor, but to resort to a device by which to increase its capital by dismembering itself and organizing another corporation of which it should be the only stockholder, and thus evade the provisions of the statute relating to the increase of the capital stock of a corporation. The defendant corporation, by the resolution, is authorized and *directed* to create a new corporation at the expense of the old one. What it is to do, therefore, is to be a corporate act done in its capacity as a corporation. Instead of increasing its capital stock in the manner provided by law, it is to separate its assets, deliver one portion of them to its own creature, capitalize that portion of stock issued by its creature; and there that transaction really ends. Affording an opportunity to the stockholders of the old corporation to subscribe to the stock of the new one is merely an offer to them to buy from the old corporation this new stock after it comes into the possession of the old corporation. [129 App. Div. 36, 40.]

Corporations cannot resort to ingenious and original methods of action with the freedom of individuals, for they are confined to those expressly authorized by statute and such as are incidental thereto and necessary to carry them into effect. If the purpose of the old corporation was to increase its capital stock, the object was lawful but the method was unlawful and this is true if its object was merely to sell its real estate. Whatever the purpose may have been, the plan was unlawful, because it would have caused an increase of the capital stock of the corporation by an unauthorized method. While the majority stockholders, or the directors, acting as individuals, could have organized the new corporation, they could not use the real estate of the old corporation to provide it with capital stock, for what was not their property. According to the scheme adopted, however, the majority stockholders were not to effect the new organization, but the board of directors, acting as such, were "authorized, empowered and *directed* to cause" the new corporation to be organized, "at the expense of the old" and by a division of its assets. This was beyond the powers of the corporation, its stockholders, and directors. Whatever is done by a corporation without authority is done in violation of law, for all action, not authorized directly or indirectly,

is prohibited. (*General Corporation Law* [L. 1890, chap. 563, as amended], sec. 10.) Any minority stockholder who opposed the scheme was entitled to an injunction, even without alleging actual injury, or the certainty thereof in the future, for he is entitled to stand on his legal rights and may refuse to accept "something better" in exchange. His legal right was to continue a member of one corporation and not to be forced into the membership of a second corporation, all the capital of which was to be taken from the assets of the former. The plaintiff is now the equitable owner of one-thirtieth of the assets of the defendant company. By the proposed plan he will be deprived of his one-thirtieth interest in the real estate and either lose it altogether or be forced to buy stock in another company, organized without the sanction of law, in order to save himself. That would in effect be a forced sale by the corporation to its own stockholders and would result in an increase of the capital stock by an unauthorized method.

If we have reasoned correctly thus far, it is obvious that the allegations in the second and third divisions of the answer constitute no defense. Even if a sale of the real estate was "necessary," as alleged in the second defense, that did not permit the organization of a corporation without authority, nor justify the spoliation of the defendant company in order to give it capital; and, if the agreement to sell was "ratified" by two-thirds of the stockholders, as alleged in the third defense, that did not validate the method of selling, as to any stockholder who objected. Ratification may confirm a voidable act, but not one utterly void.

We think that the complaint sets forth a good cause of action and that the answer, so far as before us, sets forth no defense.

QUESTIONS

1. The D Corporation has a cause of action against X on which the directors, with the acquiescence of the majority stockholders, refuse to bring action. What remedy, if any, have the minority stockholders under the circumstances?
2. The city of X is threatening to impose an illegal corporation tax on the corporation. The directors, with the acquiescence of the majority stockholders, refuse to take any action to oppose the proceedings of the city. What recourse, if any, do the minority stockholders have?
3. The directors of the corporation, with the acquiescence of the majority stockholders, are grossly mismanaging the corporation. What recourse, if any, do the minority stockholders have?

4. When the minority stockholders wish to prevent the oppressive or fraudulent misconduct of the majority, how do they proceed? In what court do they institute their proceedings? Must all minority stockholders be joined in the proceedings? To what kind of relief are they entitled?

DUNPHY *v.* TRAVELERS' NEWSPAPER ASSOCIATION

146 Massachusetts Reports 495 (1888)

KNOWLTON, J. The plaintiff brings this bill in equity, filed on December 18, 1886, as a stockholder in the defendant corporation, in behalf of himself and such other stockholders as may join him therein, alleging that Roland Worthington, one of the defendants, is the president and treasurer of said corporation, and is, and for a long time has been, the owner or controller of a majority of the shares of its capital stock, and, by means of his ownership and control, has chosen such persons to be directors as he has seen fit, and has improperly used and invested large sums of the money of the corporation in certain specified ways, and has kept other large sums of its money on hand, drawing no interest; and has improperly received large amounts as his salary as president of the corporation, and as rent for a building owned by him and occupied by it; and has prevented the making of dividends upon the capital stock, and has otherwise improperly managed the affairs of said corporation, to the great damage of the plaintiff and other stockholders. The plaintiff prays that said Worthington may be directed to render accounts of all his dealings with the assets of the corporation; and to refund all moneys improperly received or paid out by him, and to pay to certain stockholders such sums of money as shall equalize among all the stockholders certain distributions alleged to have been irregularly made among some of them; and to file a correct statement in detail of all the present assets and liabilities of the corporation, and hereafter annually to render accounts of his dealings with it as treasurer, so long as he holds that office. He also prays that all funds of the corporation on hand in excess of $5,000 be ordered distributed among the stockholders at once, and that the corporation be required hereafter to declare dividends as often as the cash on hand shall equal 5 per cent of the amount of its capital stock and for general relief.

Courts of equity are swift to protect helpless minorities of stockholders of corporations from the oppression and fraud of majorities. But the legal relations into which the members of a corporation

enter require them to seek redress of supposed wrongs done them as stockholders from its officers, and from the corporation itself, before applying elsewhere. Misconduct in dealing with a corporation, or in the management of its affairs, can affect its members only through the corporation itself. The wrong, in such a case, is done primarily to the corporation. It is the duty of its directors, or other managing officers, to protect it from those who would do it injustice, and to seek compensation for any injury which it receives. Stockholders in a corporation impliedly agree when they join it, to act, in the corporate business, through officers chosen to represent them, or by vote at meetings of the members regularly called; and so, if they deem themselves aggrieved as shareholders by the dealings of others with it, or by the acts of its managers, they are bound to seek their remedy through corporate channels: First, by application to the officers in charge; and, failing there, secondly, to the corporation itself, at a meeting of its members. If they can obtain justice at the hand of neither, the courts are open, for it would be contrary to the fundamental principles of corporate organization to hold that a single shareholder can at any time launch the corporation into litigation to obtain from another what he deems to be due to it, or to prevent methods of management which he thinks unwise. Intelligent and honest men differ upon questions of business policy. It is not always best to insist upon all one's rights; and a corporation, acting by its directors or by vote of its members, may properly refuse to bring a suit which one of its stockholders believes should be prosecuted. In such a case the will of the majority must control. It is only when the action or a corporation in refusing to proceed at the request of a stockholder is fraudulent as against him, or in disregard of his rights, that he can maintain a suit in his own name in the corporate right. The court cannot interfere with the management of corporation in matters which are properly within their discretion, so long as their discretion is fairly exercised; and it is always assumed, until the contrary appears, that they and their officers obey the law, and act in good faith toward all their members. Even when their acts are *ultra vires*, or otherwise illegal, a complaining member must first seek his remedy within the corporation. The only exception to the rule that a stockholder must apply to the directors, and also, if need be, to the corporation for redress of a wrong done it, before he can sue in a court of equity for himself, and in behalf of other stockholders, is when it appears that such application would be unavailing to pro-

tect his rights. *Brewer* v. *Theater*, 104 Mass. 378; *Allen.* v. *Wilson* (C.C.) 28 Fed. 677; *Hawes* v. *Oakland*, 104 U.S. 450, 26 L. Ed. 827; *Detroit* v. *Dean*, 106 U.S. 537; 1 Sup. Ct. 500, 27 L. Ed. 30; *Dimpfel* v. *Railway Co.* 110 U.S. 209, 3 Sup. Ct. 573, 28 L. Ed. 121; *Foss* v. *Harbottle*, 2 Hare, 461. That may happen when the directors themselves are the wrongdoers, or are in fraudulent combination with them, or when the corporation is controlled by them, or when it is necessary that action should be taken too speedily to leave time for a corporate meeting of the stockholders.

In the case at bar there is an averment that Roland Worthington, the alleged wrongdoer, has for a long time controlled a majority of the stock, and has elected such persons directors as he chose. That states a sufficient reason for not applying to the corporation at a meeting of its members for action to redress its wrongs. But it is not alleged that the plaintiff ever attempted to move the directors in the interest of the corporation, in the matters complained of, or that any good reason existed for his failure so to do. It does not even appear who, or how many, the directors are. It is said that the defendants Roland Worthington and Roland Worthington, the younger, are directors, but no others are named. The law provides that there shall be at least three, and it is to be presumed that there are others besides these defendants. There is no allegation of fraud, or of wrongful combination with Roland Worthington, or of other misconduct on the part of any of them; and it cannot be presumed, in the absence of such averments, that they would refuse to do their duty if their attention were called to it.

In *Brewer* v. *Theater*, *ubi supra*—a much stronger case for the plaintiff than this—an allegation was in these words: "A majority of the present board of directors of said defendant corporation are acting in the interest of, and are under the control of, said Tompkins and Thayer," the authors of the alleged fraud, and it was held that this allegation did not set forth a sufficient reason for bringing a suit without first requesting the directors to do it.

For the reasons which we have stated the demurrer must be sustained.

QUESTIONS

1. In what court was the action in the principal case brought? What was the nature of the proceedings? If plaintiff had made out his case, to what relief would he have been entitled?

2. What was the wrong complained of in the principal case? Was it a wrong against the plaintiff as a stockholder or a wrong against the corporation of which he was a stockholder?
3. What relief did the plaintiff ask for? Why did the court deny him the relief for which he asked? What should he have alleged and proved to have made out his case?
4. P brings a bill in equity for himself and other stockholders of the corporation alleging that the corporation through its directors is about to enter into an *ultra vires* transaction and asking that the corporation be enjoined from doing so. The corporation demurs to the bill. What decision?
5. In the foregoing case, the corporation answers the bill and says that the transaction, although *ultra vires*, will be of great benefit to the corporation and the stockholders. What decision?

DECATUR MINERAL LAND COMPANY *v.* PALM

113 Alabama Reports 531 (1896)

COLEMAN, J. Otto Palm and others, minority stockholders in the appellant corporation, filed their bill, in which it is averred that appellants, Thomas M. Scruggs and S. M. Nelson, controlled a majority of the stock of the corporation, and used their power in the selection of the board of directors, and dominated the management of the corporation for their personal advantage. The principal wrongs complained of consist in the election of incompetent and unfaithful persons as president and secretary, to-wit, Thomas M. Scruggs and S. M. Nelson, and the appropriation by the directors of exorbitant and unreasonable amounts to their salaries, and neglect of duty on their part. The bill prays for the removal of these and other members of the board of directors, for an injunction to restrain the board from voting unreasonable salaries hereafter, for an account to ascertain how much they have received over and above what is just and reasonable, a decree for such excess, and a cancellation of the notes held by such officers against the corporation for unpaid salaries, in excess of what they should be allowed. The bill also prayed for a receiver.

It will be seen from this statement of the purposes of the bill, that the corporation is the proper complainant, and that stockholders are not allowed to apply to a court of equity for relief in such a case, except upon averment and proof that the corporation has refused, upon application, to remedy the wrong, or upon sufficient averments to show that application to the board of directors or stockholders would have been in vain, or the circumstances were such as to excuse

the complaining stockholders from first seeking a remedy in this way, if there can be any other in any case.

At the final hearing, the court granted relief to complainants, in so far as the bill prayed for a cancellation of the outstanding and unpaid claims of the president and secretary for salaries, and awarded an injunction to restrain the board of directors from voting unreasonable compensation to said officers, and allowed complainants a solicitor's fee to be paid by the corporation. The respondents appeal from this decree. If the complainants were entitled to the relief granted, the benefit resulted to the corporation, and through it to all the stockholders, as such, alike. The complainants could receive no advantage of all the stockholders. If the corporation had filed the bill, there can be no doubt that its solicitors would have been entitled to reasonable compensation to be paid by the corporation. Its refusal necessitated the filing of the bill by the stockholders. Under these facts we have no doubt that the corporation is chargeable with whatever compensation the complainants' solicitors are entitled to. The amount of the fee, however, should have been determined from the evidence. We do not think the court could take judicial knowledge of the value of services rendered by the solicitors. *Clark* v. *Knox*, 70 Ala. 607. The evidence shows that S. M. Nelson and Kate Guntherz were sisters, and Thomas M. Scruggs their nephew, that these three stockholders owned but little less than the entire outstanding stock, that at some of the meetings of the stockholders, their stock exceeded a majority of the stock present and voting, and that at other meetings their stock and that held by them as proxies constituted a majority. The stock owned by these three shareholders and controlled by them was voted in concert, either S. M. Nelson or Thomas M. Scruggs generally voting that owned by Kate Guntherz.

It is reasonably clear that they dominated the stockholders' meetings, and elected the board of directors, of which the said Scruggs and Nelson were always included as members. The by-laws authorized the directors to fix the salaries of the officers and elect them. Thomas M. Scruggs and S. M. Nelson were members of the board of directors which fixed the salaries of the president and secretary, and which elected them to these offices, and it is satisfactorily shown that both were instrumental in fixing the amount to be paid, and in electing themselves to their respective offices. The pleadings and evidence show that the board of directors consisted of seven members. In the seventh paragraph of the bill it is averred, that four members, to-wit,

H. B. Scott, S. M. Nelson, Thomas M. Scruggs, and J. C. Eyster, met and re-elected Scruggs president at a named salary, J. C. Eyster vice-president, and S. M. Nelson secretary. Of necessity, Scruggs and Nelson voted for themselves. This averment is nowhere controverted. We are of opinion that the evidence leaves no room for reasonable controversy that the salaries voted to the president and secretary, when considered with reference to the duties required of and performed by them, and the financial condition of the corporation, were out of all proportion, and unreasonable. These salaries not only consumed all the income, but encroached annually upon the capital assets, and, if continued, would eventually leave nothing for the stockholders. The duty of a director is to act for the interest of the stockholders, and manage the affairs of the corporation for their benefit, and not for his personal gain. There was a direct conflict between the duty owed by these directors to the stockholders, and their self-interest; and, as it is frequently the case under such conditions, the frailty of human nature sacrifices duty to self-interest. They fixed the salaries at exorbitant prices, they elected themselves to the offices. The fact that the president may have been unwilling to accept the office at a less salary, proves nothing in favor of the fairness and reasonableness of the amount. A minority stockholder who cannot obtain redress against such a wrong, through the board of directors or the stockholders, is entitled to the intervention of a court of equity. 1 Morawetz on *Corporations*, sections 508, 518, *et seq.;* Cook on *Stocks and Stockholders*, section 657, and notes.

This brings us to the consideration of a question which vitally affects complainants' standing in a court of equity. The respondents demurred to the bill upon the ground that the bill admitted that complainants had not applied to the board of directors or to the stockholders for redress, and failed to state sufficient reasons for not doing so. The demurrer was overruled, and the same question and issue was raised by answer. After careful consideration, we are of opinion that the court erred in its ruling upon the demurrer, and in its conclusion from the facts bearing upon this issue. In the case of *Tuscaloosa Manufacturing Co.* v. *Cox*, 68 Ala. 71, we used this language:

> If it be supposed an unwise course is being pursued, or that the interests of the corporation are suffering, or likely to suffer through the inefficiency or faithlessness of an official, an appeal should first be made to the directory of governing body, to redress the grievance. Failing there, in

ordinary cases the next redress will be found in the power of the ballot, which usually comes into exercise at short intervals. We will not say there may not be cases, in which the strong, restraining arm of chancery court may be invoked in the first instance. The whole governing force may become corrupt, or may enter into a combination, either *ultra vires* or so destructive of the policy and property of the corporation, as to show an appeal to the directory would be fruitless, and delay extremely perilous. It should be a strong case, however, to justify such interferences.

In the case of *Merchants & Planters Line* v. *Waganer*, 71 Ala. 581, we quoted approvingly from the case of *Hawes* v. *Oakland*, 104 U.S. 450, the following principles of law as applicable:

A stockholder could appeal to the courts for relief, "where the board of directors, or a majority of them, are acting for their own interest, in a manner destructive of the corporation itself, or of the rights of the other shareholders." This is precisely what is averred in this case. "But," JUSTICE MILLER adds, "in addition to the existence of grievances which call for this kind of relief, it is equally important that before the shareholder is permitted in his own name to institute and conduct a litigation which usually belongs to the corporation, he should show to the satisfaction of the court that he has exhausted all the means within his reach to obtain, within the corporation itself, the redress of his grievances, or action in conformity to his wishes. He must make an earnest, not a simulated effort, with the managing body of the corporation, to induce remedial action on their part, and this must be made apparent to the court. If time permits, or has permitted, he must show, if he fails with the directors, that he has made an honest effort to obtain action by the shareholders as a body, in the matter of which he complains; and he must show a case, if this is not done, where it could not be done, or it was not reasonable to require it."

In the case of *Steiner* v. *Parsons*, 103 Ala. 215, after citing the foregoing authorities it was held that mere averments of conclusions, without averment of the facts which sustained the conclusions, were insufficient. The reasons for the principle are so strongly and clearly stated in the cases cited, that we consider it unnecessary to fortify them by additional argument or authority. It is a settled question in this court. The abstract abounds with averments, that the directors were dominated by the president and secretary, and that an application to the board would have been useless; but with one exception to be noticed presently, there is not a single fact averred to show why the board of directors would not have interposed at the request of the complainants. The fact referred to is the statement that Thomas M. Scruggs, S. M. Nelson, and Kate Guntherz had the

voting power to control the meetings of the stockholders and did dominate at these meetings. We observe here that this is the only material fact established by the evidence bearing upon this issue. The question then is, does the fact that these three stockholders controlled the election of the seven directors and did elect them by their votes, without more, authorize the legal presumption that the directors thus elected would refuse to discharge their duties as directors to the corporation and the stockholders, when requested by the stockholders? The case of *Mack* v. *DeBardeleben*, 90 Ala. 401, cannot be regarded as an authority. In the first place, this issue was not before the court. In the second place, the decision of the question was expressly pretermitted, and *arguendo*, it was stated that *possibly* "the presumption would be, that he [a director] would exercise his power in the interest of the company to which he owed his election." There is no ground for such a presumption in the present case. The directors were stockholders. In the absence of causes to influence them otherwise, the presumption is that they would do their duty, and this presumption is greatly strengthened when the effect of duty was to promote their personal interest. *Porter* v. *Pittsburgh Bessmer Steel Co.*, 120 U.S. 670. With the exception of the stockholders who as officers received salaries, the interest of the other members of the board of directors, as well as their official duty, required a prompt interference to redress the wrong. The pleadings and evidence show that two of the directors are complainants. J. C. Eyster, M. R. Leadingham, and we presume H. B. Scott, together with Thomas M. Scruggs and S. M. Nelson, comprise the seven who constituted the board of directors. We find no averment in the bill, that H. B. Scott, M. R. Leadingham, and J. C. Eyster, or any two of them, voted for the salaries, or for Scruggs as president and Nelson as secretary, nor do we find any sufficient averments in the bill, to show that they, or at least two of them, would not have co-operated with the two members who are complainants in the present bill. We are satisfied that an application to the stockholders would have been a "vain and useless undertaking." It is clear that the president and secretary dominated the stockholders. If any further evidence than that already stated was needed on this point, it is to be found in the ratification by the stockholders at a meeting held since the beginning of this suit, at which the salaries fixed and the election and conduct of the president and secretary were approved. At this meeting, the president and secretary, voting their own stock, and that of their

relative, Kate Guntherz, had no difficulty in obtaining a ratification of their own previous actions. This fact, however, did not relieve the minority stockholders from applying to the directors, unless there were other circumstances which relieved them from this duty. The bill and evidence is insufficient on this point. Ordinarily, we would render a decree of the court below, and dismiss complainants' bill, but we find difficulties owing to the condition of the case as presented in the abstract, when submitted for final decree. In the beginning of the abstract it is stated that the bill is filed against the corporation and six named directors. Included in these named directors is Kate Guntherz. This would make eight directors, yet the pleadings elsewhere and the evidence show that seven directors constituted the entire board. In the answers it is admitted that Kate Guntherz is a director as averred. Process is prayed against her as a respondent. The minutes of the stockholders' meeting held February 8, 1892, at which the directors were elected, who were in office at the time of the filing of the bill, does not show that she was elected a director, but names other seven. She was made a respondent to the bill. The abstract fails to show that as to her the case was at issue. She has not answered, and there has been no decree *pro confesso* against her. Again, the bill makes S. M. Nelson a material defendant, and the decree affects her personally. She has no answer on file. There is a mere reference in one place that she filed a plea of coverture, but this plea does not seem to have been considered by the parties or the court in any way. The abstract abounds in errors as to dates, some of which only we have been able to correct from other parts of the abstract. In this condition of the record, we have felt it our duty to reverse and remand the cause, and have stated the law applicable to the case, for future guidance of the court.

Reversed and remanded.

QUESTIONS

1. Why was the judgment of the lower court in favor of the plaintiff reversed?
2. P brings a bill in equity against the corporation of which he is a member, and its directors, alleging that the directors have sold to themselves property of the corporation at grossly inadequate prices and asking that the directors be compelled to account to the corporation for the profits which they made in the various transactions. The defendants demur to the bill. What decision?
3. P brings a bill in equity against the corporation and its directors, alleging that the directors are mismanaging the corporation in the interest of a

rival corporation of which the directors are stockholders and asking that they be removed from office and that a receiver be appointed to assume control over the affairs of the corporation. The defendants demur. What decision?

4. The corporation of which P is a stockholder has a valid claim against X and a claim which ought to be enforced. How can P, representing the minority stockholders, secure enforcement of this claim?
5. The corporation has a claim against Y, the enforcibility of which is doubtful. Will the court at the suit of P compel the corporation to sue on this claim?

PARSONS *v.* JOSEPH

92 Alabama Reports 403 (1890)

The bill in this case was filed on the nineteenth day of July, 1890, by Henry Joseph, as a stockholder in the Birmingham, Powderly & Bessemer Street Railway Co., against the said corporation and J. H. Parsons; and sought the cancellation of certain certificates of stock issued by the corporation to said Parsons on the ground that the stock was fictitious and fraudulent. There was a demurrer to the bill, and a motion to dissolve the injunction, each of which was overruled; and this appeal is sued out by the defendants from the interlocutory decree.

COLEMAN, J. The purpose of the bill is to have certain certificates of stock issued by the Birmingham, Powderly & Bessemer Street Railway Co. to defendant Parsons, canceled, on the ground that the stock is fictitious, and was issued in violation of the constitution and statute law of the state. The bill prayed an injunction, and the writ was awarded by the chancellor. A demurrer was interposed, and also an answer by the defendant Parsons. The cause was submitted for decree on the demurrer, and upon motion to dissolve the injunction. The court overruled the demurrer, and denied the motion to dissolve the injunction, and from this interlocutory decree the appeal is taken.

Among other averments, the bill substantially alleges that plaintiff is a bona fide stockholder in said company; that shortly after the organization of the company, the defendant subscribed for one hundred and seven shares of the capital stock of the company, of the par value of fifty dollars each, and paid for the same in full by conveying to the company thirty-nine acres of land (describing the land) at an agreed price and valuation of one hundred and thirty-seven dollars per acre, when the land was not worth more than twenty-

five dollars per acre, and for this land Parsons was to receive one hundred dollars and seven shares of stock; but shortly thereafter the capital stock of the company was doubled, and without further consideration than the thirty-nine acres of land, Parsons' stock was doubled, and he received two hundred and fourteen shares of the capital stock. The bill, as amended, charges that the excessive valuation of the land was made knowingly, wilfully, and with the fraudulent intent of having issued to Parsons the fictitious stock, in violation of law. This is a sufficient statement of the facts for the consideration of the demurrer.

The demurrer admits the truth of the averments. It is contended that the bill is defective in not averring that plaintiff was a stockholder at the time of the transaction, complained of as being fraudulent, or that his stock devolved upon him by operation of law.

In the case of *Dimpfell* v. *Ohio & Miss. Railroad Co.*, 110 U.S., p. 208, relied upon by appellant, it was held, that a stockholder, contesting as *ultra vires* an act of the directors, should aver "that he was a stockholder at the time of the transaction of which he complains, or that his shares have devolved on him since by operation of law." To the same effect was *Hawes* v. *Oakland*, 104 U.S. 450; and many others might be cited. Upon an examination of these authorities, it will be seen that the principle asserted rests solely upon equity Rule No. 94, adopted by the United States Supreme Court, and which may be found in the preface to Volume 104, of U.S. Reports. Morawetz on *Private Corporations*, speaking of this rule, says, it was evidently designed as a rule of practice merely, and was deemed necessary to guard courts from being imposed upon by collusion of parties. Morawetz on *Private Corporations*, sections 269, 270. The rule is not a general principle of law, applicable to pleadings in all the courts, and has never been applied to the courts of this state. The demurrer to the bill for failing to make this averment was properly overruled.

The motion to dissolve the injunction was heard upon the sworn bill and answer. The answer denied that plaintiff was a bona fide stockholder and set up that plaintiff was the transferee of one E. Lesser. The answer admits that defendant's stock was doubled without the payment of any additional consideration than that of the land; but by way of explanation and defense, avers that the lands were not truly and properly valued at first, and the increased valuation of the lands only raised them to their real and true value, and the additional issue of stock was for property at its fair valuation.

The answer continues, however, as follows: that if said transaction had been illegal, and fraudulent, and not done in good faith, complainant is estopped from setting up fraud in said transaction, or seeking to cancel said stock, because E. Lesser, who was complainant's transferrer, participated in all of said transactions and himself fixed the value of said lands, with full knowledge of and after full investigation of the value of said land.

A transferee of stock is not necessarily disqualified as a suitor in all cases, because the prior holders were personally disqualified. If the transferee purchased the shares in good faith, and without notice of the fact that the prior holder had precluded himself from suing, he would have as just a title to relief, as if he had purchased from a shareholder who was under no disability; but, if the purchaser was aware that the prior holder had barred his right to relief, neither justice nor public policy would require that the transferee, under these circumstances, should be accorded any greater rights than his transferrer. Morawetz, *supra*, section 267.

The same rule prevails in this state in favor of derivative purchasers. A claimant who was a bona fide purchaser, without notice of a fraud, or of facts which the law considers sufficient to establish it, or from which it is inferable then, could not be affected by notice to his vendor. *Horton* v. *Smith*, 8 Ala. 78; *Fenno* v. *Sayre*, 3 Ala. 458; *Weer* v. *Davis*, 4 Ala. 442; *Martinez* v. *Lindsey*, 91 Ala. 334; Wait on *Insolvent Corporations*, sections 628, 630.

If a stockholder participates in a wrongful or fraudulent contract or silently acquiesces until the contract becomes executed, he cannot then come into a court of equity, to cancel the contract, and more especially, if the company, or himself, as a stockholder, has reaped a benefit from the contract; and this rule holds good, although the consideration of the contract may be one expressly prohibited by statute. The same disability would attach to the transferee of his stock who bought with notice. We consider this general rule of equity abundantly sustained. Morawetz on *Private Corporations*, sections 261, 262; Cook on *Stock and Stockholders*, sections 39, 40, 735; *Wright* v. *Hughes*, 12 Amer. St. Rep. 413. It is sustained by the familiar rule that he who invokes the aid of a court of equity must have clean hands. Mr. Cook states the conditions upon which a stockholder can sustain a suit to remedy the frauds, *ultra vires* acts or negligence of directors, to be, first, the acts complained of must be such as to amount to a breach of trust, and such as neither a majority

of the directors nor of the stockholders can ratify or condone; second, that the complaining stockholder himself is free from *laches*, or acquiescence in the acts to remedy which the suit is brought; third, that the corporation has been requested and refused or neglected to institute the suit, that the suit is instituted by bona fide stockholders as complainants, and that the corporation and the guilty parties, and other proper parties have been made defendants. Cook, *supra*, section 646.

If the averments of the bill are sustained by proof, the stock issued to the defendants was in violation of section 1662 of the Code and of section 6, Article XIV of the Constitution. On the contrary, if the proof shows that the property was received in payment of stock, at a fair valuation, such would not be the result. *Davis Brothers* v. *Montgomery Fur. & Chemical Co.*, at present term.

In cases where the stockholders or the company by any *laches*, acquiescence, or participation in the unlawful and fictitious issue of the stock or for any other sufficient cause are precluded from instituting the proper proceedings, to remedy the wrong, the remedy is still open to the state to institute all necessary and proper proceedings to vacate and dissolve the corporation, or have such other proper judgment and decree rendered, as the proof and justice may demand.

It may be that stockholders, who knowingly and intentionally have subscribed and paid for stock with property upon a fictitious valuation, are liable as stockholders who have not paid up in full for their stock, within the meaning of the statute, to creditors who have not precluded themselves from maintaining this suit. Wait, *supra*, section 593; *Douglas* v. *Ireland*, 73 N.Y. 100; *Boynton* v. *Andrews*, 63 N.Y. 93.

Applying the rule of law applicable when a motion to dissolve an injunction is submitted upon bill, exhibits, and answer, and considering only so much of the answer as is responsive to the bill, we are of opinion that the decretal order, overruling the demurrers and motion to dissolve the injunction, is free from error.

Affirmed.

QUESTIONS

1. The D Company with the assent of all of its stockholders executed an *ultra vires* lease of its property to X. P, a stockholder of the corporation, brings this bill against the D Company and X, asking that the lease be canceled. What decision?
2. In the foregoing case, P transfers his stock to B who is at the time ignorant of the *ultra vires* transaction. He brings this bill to have the transaction declared void. What decision?

3. The D Company entered into an *ultra vires* contract. P, among other stockholders, objected to the transaction. P transfers his stock to B who takes the stock without knowledge of the *ultra vires* transaction. B brings this action, asking that the transaction be declared void. What decision?
4. In the foregoing case, B buys the stock with knowledge that the corporation had just entered into the *ultra vires* transaction. B asks that the transaction be declared void. What decision?
5. P, owner of one share of stock in the D Company, brings a bill, asking that the corporation be enjoined from entering into a certain *ultra vires* transaction. The corporation contends that he cannot maintain this bill because his interest is so slight. What decision?
6. P knows that the D Company has executed an *ultra vires* lease of its property. He buys five shares of stock which is not estopped to question the validity of the transaction for the very purpose of beginning litigation to upset the transaction. What decision in an action by P to have the lease canceled?
7. P is a large stockholder in B Company, a rival of the D Company. He buys ten shares of stock in the latter company and brings proceedings to have the transaction in question canceled. His purpose is to embarrass the D Company. What decision?

b) Powers of Individual Members

KATZ *v.* BREWINGTON

71 Maryland Reports 79 (1889)

Charles Brewington filed a bill of complaint against Louis Katz, alleging that in May, 1887 they had entered into a copartnership under the name of L. Katz & Co.; and that the business had been carried on under the firm name until the time of the filing of the bill. It was further charged that the books of the firm were in the possession and control of Louis Katz, who refused to permit the complainant to have access to the same; and that Katz had sole control and possession of the goods of the firm, and was disposing of the same in fraud of complaint.

That complainant no longer felt safe with the books and papers and assets of said firm in the possession of said Katz, and desired that said copartnership should be wound up under the order and direction of this court.

That Katz absolutely excluded complainant from all control of the business, and refused to give him any information in regard to

the business of the firm, having carried the books of the firm away from the place of business of said firm, and refused to disclose the place where said books were deposited.

The court ordered an injunction, and set down for hearing the application for a receiver, directing that notice should be given to the defendant. The notice was not served in due time; but, nevertheless, the parties appeared in court, by counsel, on the day appointed for the hearing, and after the court had heard their statements on the bill and exhibit, it appointed a receiver. After the appointment of a receiver, an answer was filed by defendant, and an appeal was taken.

BRYAN, J. We are, of course, on this appeal, confined to the statements of the bill of complaint. The defendant might have objected to the motion for a receiver, on the ground that he had not received the required notice; but he does not appear to have done so. If he had filed his answer before the hearing, it would have been considered, both in the court below, and in this court.

The time appointed for the continuance of the partnership had expired before the filing of the bill of complaint, and it was then existing only by the mutual consent of the partners. The agreement of partnership required Katz to furnish all the capital, and the profits were to be equally divided, after payment of debts and expenses. It was not alleged by the complainant that any profits had been made, or that there were any debts due by the partnership. It was, however, alleged that the defendant had excluded from him all control of the business of the firm; and had refused to give him any information respecting it, and had carried away the books from the place of business, and had refused to disclose the place in which they were. Each partner has an equal right to take part in the management of the business of the firm; although one of them may have an interest only in the profits, and not in the capital, yet his rights are involved in the proper conduct of the affairs of the firm, so that profits may be made. So each partner has an equal right to information about the partnership affairs, and to free access to its books. The complainant had a right to learn from the books whether there were profits, and whether there were debts. If he were denied this information, as charged in his bill of complaint, a sufficient reason appears for not alleging that profits had been earned, and that debts existed. In *Ernst* v. *Harris*, 1 Turner & Russell, 496, LORD ELDON said: "The most prominent point on which the court acts in appointing a receiver

of a partnership concern, is the circumstance of one partner having taken upon himself the power to exclude another partner from as full a share in the management of the partnership as he, who assumes that power, himself enjoys." This principle seems to be universally approved by the authorities. It is decisive of the present question. The order must be affirmed.

QUESTIONS

1. What was the relief asked for in the principal case? Why was this particular relief asked for? To what other relief might the plaintiff have been entitled?
2. Suppose that it had been agreed by the partners in their articles of partnership that the defendant should have the exclusive management of the business, would the court have reached the same conclusion?
3. A and B are engaged in business as partners. By their agreement, A furnished all the capital and B furnished his skilled service. A excludes B from any part in the management of the concern. To what relief, if any, is B entitled?
4. Compare the right of a stockholder in a corporation to participate in the management of the business, with the right of a partner so to participate.

MORTON GRAVEL ROAD COMPANY *v.* WYSONG

51 Indiana Reports 4 (1875)

Downey, J. With reference to the by-law of this corporation, set out in the agreement of facts, it may be remarked, that it was passed or adopted by the directors of the corporation, and not by the company, and the question arises, therefore, whether the directors could legally pass the by-law, supposing it to be one which in other respects might be legally enacted. The fifteenth section, to which we have already referred, gives the power to make by-laws to the company. Its language is, "Such company may fill all vacancies occurring in their board of directors, by resignation or otherwise, by the remaining directors, at any of their meetings, and may make, enact, and publish any and all ordinances and by-laws which they may deem proper," etc. While the company may fill vacancies by the remaining directors, the directors are not empowered to enact by-laws. This must be done by the corporators, or company. Omitting the part of the language quoted which relates to filling vacancies, the remaining part reads as follows: "Such company may make, enact, and publish any and all ordinances and by-laws," etc.

This is in conformity to the statute on the subject, entitled "an act establishing general provisions respecting corporations," 1 G. & H. 267, section 2 of which provides that "corporations shall, where no other provision is specially made, be capable, in their corporate name, to make necessary by-laws," etc.

The power to make by-laws resides in the members of the corporation at large, where there is no law or valid usage to the contrary.

QUESTIONS

1. What are the functions of the by-laws of a corporation?
2. Does a corporation have the power to adopt by-laws in the absence of an express authorization to do so?
3. By whom should the by-laws be drawn up? By whom adopted? What considerations should govern in the matter of drawing up and adopting by-laws?
4. What matters are usually regulated by the by-laws of an organization?
5. Does a partnership usually have by-laws? Does it need them?

BANK OF HOLLY SPRINGS *v.* PINSON

58 Mississippi Reports 421 (1880)

This is an action of assumpsit brought by Sina D. Pinson against the "Holly Springs Savings and Insurance Co.," whose name was changed, pending the litigation, to the "Bank of Holly Springs." The object of the suit was to recover damages for the refusal of the bank to transfer on its books certain certificates of stock which had been assigned to the plaintiff by B. S. and William Crump. The bank defended the action on the ground that the Crumps were indebted to it in an amount exceeding the value of their stock, and that, under a by-law of the corporation, the bank had a lien upon the stock assigned, for their indebtedness, and they were prohibited from transferring their stock in such circumstances. A supplemental statement of the case will be found in the opinion of the court.

GEORGE, J. The principal question raised by this record is whether the plaintiff in error, under its charter and by-laws, and the certificates of stock involved in this controversy, has a lien on the stock as against the defendant in error.

By the third section of the charter of the Holly Springs Savings and Insurance Co., now called the Holly Springs Bank, a directory of five persons and a president were provided for, and they were empowered to make "all needful rules, by-laws, and regulations for

the control and management of the business and affairs of said company, its property, and the *mode and manner* of transferring its stock, and any and all other questions which in their judgment will promote the interest of said company; *provided*, the same are not inconsistent with the Constitution and laws of the United States or this state."

Under this section the company made various by-laws, of which section 13 provided that "the stock of the company shall be assignable only on the books of the company; and a transfer-book shall be kept, in which all assignments and transfers of stock shall be made, and no transfer of the stock of the association shall be made by any stockholder who shall be liable to the company for any sum of indebtedness, either as principal or otherwise, and *certificates of stock shall contain upon them notice of this provision.*" Section 14 provided that "certificates of stock, signed by the president and cashier, may be issued to stockholders, and that the certificates shall state on their face that the stock is transferable only upon the transfer-books of the company; and when stock is transferred, the certificates thereof shall be returned to the company and canceled and new certificates issued."

In February, 1894, a certificate for stock duly signed, was issued to B. S. Crump, as follows: "This is to certify that B. S. Crump is entitled to eighty-two shares, of fifty dollars each, numbered 78, in the Holly Springs Savings and Insurance Co., transferable at the office, in person or by attorney." At the same time a similar certificate numbered 79, was issued to William Crump.

In March, 1878, B. S. and W. Crump, being in possession of these certificates, borrowed $6,000 from the defendant in error, and assigned both these certificates to her as collateral security for the loan. This assignment was indorsed on the back of each certificate, and is in the following words: "For value received, I assign this certificate of stock to S. D. Pinson, and authorize her, as my attorney, to demand and have transfer of the same made to her on the books of the company," and signed by the assignor.

Mrs. Pinson, before advancing the money, gave notice of this pledge to the bank; and the note given for the loan not falling due till the fall of the year, when yellow fever was raging in Holly Springs, and the bank on that account was closed, she made no demand for a transfer on the books till in December of the same year, which transfer being refused by the bank, she brought this action to recover

damages on account of said refusal. She recovered judgment for the full value of the stock, $8,200.

The cause has been argued with distinguished ability on both sides, both at the bar and in writing. The authorities cited on both sides are very numerous, and their perusal has greatly aided us in arriving at the conclusion we have reached.

It is well settled that at common law a corporation has no lien on the stock of its shareholders for an indebtedness to it. Such liens, when they exist, result either from a provision in the charter to that effect, or from a by-law enacted by the corporation in pursuance of authority conferred by the charter. Usually the lien, when it exists at all, is given by the charter, which, being a public law, as well as the act by which the corporation is created, is notice to all persons dealing with the company. *Union Bank* v. *Laird*, 2 Wheat. 390. The lien may, however, be created by a by-law, as was held at an early day by Lord Chancellor Macclesfield in *Child* v. *Hudson Bay Co.*, 2 P. Wms. 12, and very generally since. When thus created, there seems to be some diversity of opinion as to its effect against an innocent purchaser of the stock for value and without notice of the lien. Morse, in his work on *Banks and Banking* (p. 442), denies that the lien can be created by by-law alone as against such purchaser, and Potter on *Corporations* (sec. 355), says this is unsettled.

This difference is more apparent than real, for it seems to be well recognized that a by-law has no extra-corporate force, and is only binding on those dealing with the corporation who have notice of it, or who deal with it under such circumstances that they are bound to take notice of it. A solution of the question will be found in the right determination of the categories in which notice is inferred. By-laws of private corporations are not in the nature of legislative enactments, so far as third persons are concerned. They are mere regulations of the corporation for the control and management of its own affairs. They are self-imposed rules, resulting from an agreement or contract between the corporation and its members to conduct the corporate business in a particular way. They are not intended to interfere in the least with the rights and privileges of others who do not subject themselves to their influence. It may be said with truth, therefore, that no person not a member of the corporation can be affected in any of his rights by a corporate by-law of which he has no notice. In some instances, as we have seen, if he have no actual notice he will be held to have constructive notice. In dealing with an

officer or agent of the company, a third person, as in other cases of agency, is bound to ascertain the authority of the person with whom he deals. If he deal with an officer—as, president or cashier—the general scope of whose duties is well known and ascertained by law, he may rely, without further inquiry, on such officer possessing the ordinary and usual powers. He is not bound by any secret limitation or restriction placed on them by the by-laws or otherwise. If he deals with such officer in relation to a matter outside of these ordinary and usual powers, or with a special agent, he is bound to inquire into his authority. So, if the transaction be about a matter on which, by the terms of its charter, there must be a regulation of the company as to the mode of doing it, he is bound to make inquiry as to the mode. Applying these principles to the case before us, we find that the president and cashier are the persons usually employed to give certificates of stock, and that the former, as head of the corporation, is the appropriate person to give the certificate, in so far as it relates to the membership of the shareholder, and that the cashier, the executive hand of the corporation as to its financial matters, may appropriately certify to the pecuniary interest of the shareholder. Mrs. Pinson, therefore, was under no obligation to make any inquiry as to the power of these officers to sign the certificates of stock, and in fact their actual authority is not disputed. On looking at the charter, she learned that the "mode and manner" of making the transfer of the stock was subject to the regulation of the company by its by-laws, but she found nothing which specifically authorized the company to interfere with the power of disposing of his stock possessed by each stockholder. The president and directors were authorized to regulate the "mode and manner" of the transfer of stock. This did not include the authority to prevent, or even to restrict, the power of disposition. If this authority exists at all, it results from the general power conferred in the charter to make all needful rules and regulations for the management and control of the business of the corporation. She did not, therefore, have notice from the charter that there would be any by-law preventing a disposition of his stock by a debtor to the bank. The utmost that can be inferred against her on this subject is, that as there must be some mode in which the *jus disponendi* of the shareholder as to his stock must be exercised, she was bound to take notice that there was a regulation on this subject. She was bound only to know as to the "mode and manner" of the transfer, and this information was conveyed to her in the certificate itself,

in the phrase "transferable at the office, in person or by attorney." Having this information on the face of the certificate itself, issued by the proper officers of the company, she was not bound to inquire further. She had a right to repose confidence in the terms of the certificate of the stock. That the form in which certificates are issued is material and binding on the bank, and may be relied on by a purchaser, is well settled. It is also settled that the statements of such certificates as to the manner of their transfer constitute the regulation on that subject. *Lanier* v. *Bank*, 11 Wall. 369; *Vansands* v. *Middlesex County Bank*, 26 Conn. 144. The power of a shareholder to dispose of his stock is not derived from the bank. It is inherent in him as a part of his proprietorship. The bank's power is simply to regulate the mode of its exercise. When this certificate said that Crump was entitled to the named shares of stock, and that they were "transferable at the office, in person or by attorney," it asserted the right of a purchaser to have the transfer made at that place, and it asserted no more. The certificate did not say even that there were by-laws of the bank according to which the transfer was to be made, as is usual in such certificates. It contained no intimation on its face of any restriction on the power of transfer, nor did it refer to any other instrument in which such restriction might be found. The assignability of these certificates resulted from a right of the shareholder to dispose of his property. The ease with which assignments could be made was an essential element in the value of the shares, enhancing it both to the shareholder and the bank. It is true, they are not commercial paper; but, as it was said in *Lanier* v. *Bank*, 11 Wall. 369, they approximate it as near as practicable.

The bank having adopted a form, in this case, which asserted the right to transfer with no other limitation on it than that it should be done at the office of the bank, and with no reference to the existence of any by-law or regulation which might impose other restrictions, good faith and fair dealing require that the purchaser in good faith, acting according to the terms of the certificate, should be protected. But there is another ground equally conclusive against the right of the bank to assert this lien against Mrs. Pinson. The by-law under which the lien is asserted directed that notice of the lien should be given by the certificate. This was not done. It is not claimed that this certificate, as it was phrased, was unauthorized; in fact, it was admitted in the argument that all the certificates ever issued by the bank were in the same form. This would therefore be held to have

been done with the consent of the directors, who, being stockholders, received their certificates framed as these were. The provision in the by-law requiring the notice must be held to mean that the lien would not be asserted against a person not having this notice. The by-law was binding on the company and its members as a legislative act. The company cannot be heard to assert a claim in violation of its own by-law, especially when the violation is in a matter essential to the protection of the party against whom the claim is asserted. Moreover, the power to make the by-law was not by the charter vested in the shareholders, but in the directory. The board could therefore waive or repeal it. Angell and Ames on *Corporations*, section 354. There was here both a waiver and a repeal, so far as the purchasers of the stock were concerned. The waiver was in the issuance of these particular certificates with the omission of the provision as to the notice. The repeal arose from the uniform course pursued by the bank in issuing certificates with the omission. Corporations are not permitted to pass by-laws in secret, and by their conduct to the outside world induce a belief in their non-existence. This uniform conduct, at least as to all who are not members of the corporation, will be held as making a by-law repealing the other. By-laws need not be in writing. They may be adopted as well by the company's conduct, and the acts and conduct of its officers, as by an express vote or an adoption in a meeting. Field on *Corporations*, section 305.

We therefore conclude that the corporation had no lien as against the rights of Mrs. Pinson. Probably the lien exists as against the Crumps, and for this reason the judgment will be reversed, so that the recovery of Mrs. Pinson may be limited to the amount of the debt and interest in the reasonable attorney's fees stipulated to be paid in the contract of loan. And the defendant in error agreeing to remit all but the principal and interest of the debt, and that judgment should be entered for that amount, it is ordered accordingly.

QUESTIONS

1. The D Company was incorporated with a capital stock of $100,000, to be divided into a 1,000 shares of the par value of $100 a share. Seven hundred and fifty shares of the authorized stock were subscribed and paid for. The corporation, needing additional working capital, adopted a by-law authorizing the directors to issue the balance of the stock as preferred stock. Certain of the stockholders of the corporation ask

that the corporation be enjoined from issuing this stock as preferred stock. What decision?

2. In the foregoing case, the corporation adopted a by-law providing for assessments upon the common stock in addition to the par value already paid. This is an action by the corporation against S on an assessment made under the authority of the by-law in question. S contends that the by-law is invalid. What decision?
3. A, B, and C are members of a trading partnership. They adopt a by-law which provides that no negotiable paper shall be issued in the firm name without the concurrence of all the partners. A, in violation of this by-law, issues a promissory note in the firm name. H, a holder in due course of the instrument, brings an action on it against the firm. What decision?
4. What is the effect of a regularly adopted by-law on members of the organization? on third persons who deal with the organization?

MILLER *v.* EWER

27 Maine Reports 509 (1847)

SHEPLEY, J. This is a writ of entry brought to recover a tract of land in the town of Bluehill, upon which a granite store has been erected. The demandants derive their title from the Bluehill Granite Co., and introduce a conveyance by deed of mortgage, of a tract of land, including the premises demanded, purporting to be executed by that company on April 6, 1837, by its president, John S. Labaugh, and its secretary, David E. Wheeler, to Matthew C. St. John, in trust for the benefit of certain persons therein named. And conveyances from the trustee and the *cestis que trust*, assigning that mortgage to William I. Tenney. Also copies of judgment recovered by William I. Tenney against that company, and of an execution issued thereon, and of the return of an officer upon it, showing a seizure and sale of the company's right to redeem that mortgage to William I. Tenney; and a deed of the same from the officer to him on June 2, 1840. And a deed from William I. Tenney to the demandants, made on June 29, 1843.

To prove that the president and secretary of that company were authorized to make and execute the mortgage to Matthew C. St. John, the records of the company were introduced; and the charter granted by an act of this state, approved February 29, 1836. The records of the board of directors were also introduced. It appears from those records, that a meeting of the corporators was called for

the organization of the corporation, under its charter in the city of New York, and that the charter was there accepted, and the officers of the corporation, president, secretary, and directors were chosen. And at a meeting of those directors, held in that city on April 6, 1837, the president and secretary thus chosen, were authorized by vote to make and execute the conveyance in mortgage to Matthew C. St. John. There is no proof, that any meeting for the organization of the company, or for the choice of its officers, has ever been holden in this state. There is proof that the company, by a person acting as its agent, transacted business in this state, during the years 1836, 1837, and 1838.

It is contended, that the existence of the corporation is sufficiently proved by the introduction of its charter, and by the testimony, showing the transaction of business under it.

If this be admitted, the demandants must proceed further, and show that the persons who executed the conveyance in mortgage, were legally authorized to do it. If directors of the corporation, legally chosen, might transact business as such by vote of the board, at a meeting held in another state, and might authorize persons to execute a conveyance of real estate, yet it would be necessary, to show that such persons were legally chosen directors, before any conveyance made by their direction could be considered as legally made.

The demandants must recover upon the strength of their own title, not because the tenant does not exhibit a legal title; and their right to recover will depend upon a decision of the question, whether the corporation has authorized any board of directors or other persons to make that conveyance of its estate.

There are a variety of corporations. It will only be necessary on this occasion, to speak of one class of them, corporations aggregate, composed of natural persons. It is often stated in the books, that such a corporation is created by its charter. This is not precisely correct. The charter only confers the power of life, or the right to come into existence, and provides the instruments by which it may become an artificial being, or acting entity. Such a corporation has been well defined to be an artificial being, invisible, intangible, and existing only in contemplation of law. The instruments provided to bring the artificial being into life and active operation are the persons named in the charter, and those who, by virtue of its provisions, may become associated with them. Those persons or corporators, as natural persons, have no such power. The charter confers upon

them a new faculty for this purpose; a faculty which they can have only by virtue of the law, which confers it. That law is inoperative beyond the bounds of the legislative power, by which it is enacted. As the corporate faculty cannot accompany the natural persons beyond the bounds of the sovereignty, which confers it; and they cannot possess or exercise it there; they can have no more power there to make the artificial being act than other persons not named or associated as corporators. Any attempt to exercise such a faculty there, is merely an usurpation of authority by persons destitute of it, and acting without any legal capacity to act in that manner. It follows that all votes and proceedings of persons professing to act in the capacity of corporators, when assembled without the bounds of the sovereignty granting the charter, are wholly void.

This is a familiar principle, when applied in analogous cases to persons, upon whom the law has conferred some power or faculty, which, as natural persons, they do not possess.

The power conferred by law upon executors and administrators, cannot accompany their persons beyond the bounds of the sovereignty, which has conferred it. Story has collected numerous cases, in note under section 512, in his treatise upon the *Conflict of Laws*, proving the doctrine to be established both in England and in this country.

The same doctrine generally prevails in this country, while it does not in England, respecting the powers of assignees under bankrupt and insolvent laws. The doctrine is stated and discussed and the cases are collected by Story in his treatise on the *Conflict of Laws*, chap. 9, secs. 405 to 417.

If the artificial being, called the Bluehill Granite Co., may be considered as having existence and active life in this state, by proof of its acts within her limits, it will be still true that it cannot have existence without her limits and of course cannot make choice of any officers or agents there. It may maintain a suit without those limits, but that does not imply its existence or presence there. It may also contract without those limits. Being within them, it may, acting per se, by vote transmitted elsewhere, propose a contract or accept one previously offered. And it may, by an agent or agents duly constituted, act and contract beyond those limits. But it can neither exist, nor act per se, without them, except by the assistance of its officers or agents duly elected or appointed within them.

The constitution and powers of such corporations were perhaps more thoroughly discussed and fully considered than ever before by

any judicial tribunal, in the case of the *Bank of Augusta* v. *Earle*, 13 Peters, 519. C. J. TANEY, delivering the opinion of the court, says, "It is very true, that a corporation can have no legal existence out of the boundaries of the sovereignty by which it is created. It exists only in contemplation of law; and where the law ceases to operate and is no longer obligatory, the corporation can have no existence. It must dwell in the place of its creation and cannot migrate to another sovereignty."

The cases of *McCall* v. *The Byram Manufacturing Co.*, 6 Conn. R. 428, and of *Copp* v. *Lamb*, 3 Fairf. 314, are relied upon as deciding, that corporations whose charters were granted by one state, could hold meetings, pass votes, and exercise powers in another state.

The question presented in the former case was whether the secretary of a corporation was legally appointed by the directors at a meeting held by them in the city of New York. The charter had been granted by the state of Connecticut. The decision was in the affirmative.

The directors of a corporation are not a corporate body, are, when acting as a board, but a board of officers or agents, and they may exercise their powers as agents beyond the bounds, where the corporation exists. It did indeed appear in that case, that all the meetings of the stockholders, and of the directors, were held in the city of New York, but the capacity of the stockholders to act there, does not appear to have been examined or discussed.

If there were no legally existing mortgage, there could be no legal sale at auction of the right of the corporation to redeem it. In such case the execution could only be satisfied from the real estate of the corporation by a levy and appraisal. Tenney obtained no legal title by that seizure and sale, and he could convey none to the demandants.

Under such circumstances it will not be necessary to consider whether the tenant obtained any title whatever by the proceedings stated in the testimony.

Demandants nonsuit.

QUESTIONS

1. Do you conclude from the decision in this case that a corporation organized in one state can do no business in another state? If not, precisely what does the case decide?
2. Can the directors of a corporation, meeting in a foreign state, bind the corporation by their action?

3. Is the rule of the principal case applicable to meetings of partners?
4. The directors of a corporation pass a resolution, authorizing the execution of a mortgage on corporate property to C. By a provision in the charter of the corporation the mortgage does not become binding upon the corporation until it has been ratified by the stockholders. A majority of the stockholders individually and informally assent to the resolution. The directors execute and deliver the mortgage deed to C. In proceedings to foreclose the mortgage, the corporation contends that the mortgage was never legally executed. What decision?

GILCHRIST *v.* COLLOPY

119 Kentucky Reports 110 (1904)

BARKER J. The Newport & Covington Bridge Co. owns and operates a bridge over the Licking River, connecting the two cities of Newport and Covington. The stock of the corporation consists of 1,000 shares of the par value of twenty-five dollars each, the whole owned by the two municipal corporations equally. By the charter, the affairs of the corporation are to be managed by five directors, chosen annually by the shareholders on the first Monday in June. There seems to have been a working agreement between the cities that in alternate years one should elect three, and the other two, of the directors.

On the the first Monday in June, 1903, the mayor of Covington attended at the office of the bridge corporation, and being properly authorized so to do, voted the stock of the city of Covington for the appellees as directors for the ensuing year. The stock of the city of Newport was not represented at the meeting. The appellees qualified by taking the oath of office, and presented themselves to the corporation for installation, which was refused on the ground that there had been no legal election, and therefore they were not directors. Whereupon they instituted this action in equity against appellants for the injunction restraining them from preventing appellees exercising their duties as directors. Without further statement of the pleadings in this case, it is sufficient to say that they present for adjudication the following questions: (1) Can less than a majority of the shareholders of a private corporation, upon the regular charter day, hold a valid election for directors? (2) Can persons claiming to be elected directors at such meeting, upon the refusal of the corporation to permit them to be installed, be placed in office in an equity action for an

injunction? (3) Was the election void because only two of the five directors were elected? Of these in their order.

There is no question in this action as to sufficiency of notice of election, it being held on the day prescribed in the charter. Only half of the stock was represented. Some confusion has arisen on the subject in hand by a failure to distinguish those cases which turn upon statutes or by-laws which require the presence and participation of the holders of a majority in value of the shares in order to constitute a legal quorum for the purpose of transacting the business of the corporation, from those cases which turn upon the common-law regulation of the matter. As we have no statute bearing upon this subject, and there is no provision in the charter of the by-laws of the corporation prescribing what proportion of the shares constitute a quorum, we must, of necessity, rely upon the common-law rule.

In Morawetz on *Private Corporations* (2d ed.), section 76, the rule is thus stated: "The majority of a corporation means that portion of the shareholders present at a general meeting who are entitled to control the corporation by their votes. It is not necessary that the majority of all the shareholders or a great part of its shares be present at a meeting in order that the resolutions of the meeting shall be binding on the corporation. In the absence of an express provision to the contrary, the rule is that such of its shareholders as actually assemble at a properly convened meeting constitute a quorum for the transaction of business, and a majority of that quorum have authority to represent the corporation." Kent, in his *Commentaries*, Volume 2, page 293, says: "There is a distinction taken between a corporate act to be done by a select and definite body, as by a board of directors, and one to be performed by the constituent members. In the latter case, a majority of those who appear may act; but in the former, a majority of the definite body must be present, and then a majority of the quorum may decide. This is the general rule on the subject, and, if any corporation has a different modification of the expression of the binding will of the corporation, it arises from the special provision of the act or charter of incorporation." Cook, in his work on *Corporations* (4th ed.), section 607, says: "The question has arisen whether the meeting can be held and business transacted when the majority in interest of the stockholders are not present. But the law is clear that the stockholders who attend a duly called stockholders' meeting may transact the business of the meeting although a majority in interest, or in numbers, of the stockholders are not present. . . . ."

The case of *Brown* v. *The Pacific Mail Steamship Co.*, 5 Blatchf., 525, Fed. Cas., No. 2025, was an action instituted by the stockholders of a majority of a corporation to prevent an election for directors to take place until certain questions relating to the right to vote the stock could be settled, it being alleged that at the approaching election the stockholders who constituted a minority had entered into a conspiracy to obtain an injunction against the holders of the majority of the stock, preventing them from voting, and before the matter of injunction could be adjudicated the minority would elect directors and secure control of the corporation. It became necessary for the court to consider whether such an election would be valid. If valid, the holders of the majority of the stock would be injured; if invalid, they would have no ground for injunction. The court said:

> Certainly, if there ever was a case for relief of some kind by injunction, this case is one of that kind, to prevent the commission of so great and admitted a wrong, wholly undefended. It is a case in which there would be no adequate remedy at law, because the law, as settled by the Supreme Court of the United States, in regard to the jurisdiction, in suits in equity, of the courts of the United States, in view of the statute which declares that there shall be no remedy in equity where there is a plain, adequate, and complete remedy at law, is that the remedy at law must be as efficient to the ends of justice, and its complete and prompt administration, as the remedy in equity. Now, in the present case, the election taking place under these circumstances, which it is thus admitted will be the circumstances of the case, would be perfectly legal, although accomplished in this way by a minority of the votes. There would be no ground, so far as I am able to perceive, for setting aside the election, because an injunction, obtained from a proper court having jurisdiction, had excluded certain persons from voting.

The learned judge thus fully recognized that a minority in value of the shares of the stock of a corporation could hold a valid election for directors, although the majority were kept from participation therein by the wrongful acts of the minority. The principle has not been carried so far in any other case with which we are acquainted.

In the case of *Morrill* v. *Little Falls Manufacturing Co.* (Sup. St. of Minn.) 55 N.W., 547, 21 L.R.A., 174, it is said:

> The second objection [a want of a majority of the stockholders at the meeting] is equally untenable. Where the charter and by-laws of a corporation are silent on the subject, the common-law rule is that such of the

shareholders as actually assemble at a properly convened meeting, although a minority of the whole number, and representing only a minority of the stock, constitute a quorum for the transaction of business, and may express the corporate will, and the body will be bound by their action. [Omitting authorities cited.] The contention of the appellants, that this rule applies only to such organizations as towns, churches, and the like, and not to stock corporations, finds no support either in reason or authority. The correct distinction is between a corporate act to be done by a select body, of a definite number, as, for example, a board of directors or trustees, and one to be performed by the constituent members of the corporation. In the latter case, a majority of those who appear may act.

The reason for the common-law rule is obvious. If it were otherwise, the affairs of the corporation, through either the negligence of the malevolence of a majority of the shareholders, might be allowed to go to ruin. We know of no power by which the shareholders can be forced to attend the meeting of the corporation, but the law affords a sufficient remedy for this danger by placing the control of the property in the hands of those shareholders who are sufficiently interested in its affairs to attend the corporate meetings. If the rule we have announced did not prevail, a designing majority of the shareholders, who had obtained possession of the corporation by electing the directors, could retain the management indefinitely, no matter how injurious that management might be to its affairs, by simply abstaining from its corporate meetings.

We are not impressed with the suggestion that the election was void for the reason that only two directors were elected, instead of five. The charter provides that five directors shall be elected annually, and that they shall hold over until their successors are elected. As said before, there seems to have been a working agreement between the two cities, who owned the stock as to which should elect two, and which should elect three, of the directors in any one year. In 1903 it was Covington's time to elect only two directors, and in good faith it carried out that agreement, although accomplished in this way by a minority of the votes. There it might have elected the five, in the absence of the stockholders of the city of Newport from the meeting. The agreement between the cities alluded to is essential to harmony between them, each owning one-half of the stock, and there being five directors to be elected. It is one so absolutely practical and so eminently fair that we think it should be upheld.

Perceiving no error in the record, the judgment is affirmed.

QUESTIONS

1. What rule does this case lay down with reference to the sufficiency of corporate action? Does the same rule apply to the sufficiency of actions by directors?
2. How many votes is a stockholder in a corporation entitled to? Does the voting right of a partner depend upon his interest in the partnership?
3. What persons are entitled to vote at corporate meetings? May a trustee of stock vote? May a pledgee of stock? May a transferee whose name has not been entered upon the books of the corporation?
4. What is meant by cumulative voting of stock? What is the purpose of cumulative voting? Is a stockholder, in the absence of express authorization, entitled to cumulate his votes?
5. Is a stockholder entitled to vote by proxy? Can the corporation, in the absence of express authority, confer the privilege of voting by proxy on stockholders by a by-law?
6. What is the doctrine of *Smith* v. *San Francisco Railroad Co.*, *supra*, page 415, with reference to the voting privilege?

FOSTER *v.* WHITE

86 Alabama Reports 467 (1888)

In this case, an application was made on the thirtieth of January, 1889, in the name of the state, on the relation of Joel White, for a mandamus to T. Gardner Foster, as secretary and treasurer of the Montgomery Gas-Light Co., or the Montgomery Light Company, a private corporation, requiring him to allow the relator, who was a stockholder in said corporation, to inspect and examine its books, records, and papers. The petition alleged that demand for an inspection of the books, etc., was made by the petitioner, as a stockholder, through P. C. Massie, "his attorney in fact, duly and legally authorized to that end"; and that "it was in all respects, as to time, place, and circumstances, reasonable and proper, having been made during the regular office hours of said Foster, at the office of said corporation, where its books and records were kept, and at time when they were not being used by any other person." The defendant demurred to the petition (1) because it showed that the demand was not made by the stockholder himself, and it was not shown that he was personally incapacitated; (2) because it did not allege or show that the demand was made for any lawful purpose; nor (3) that any particular purpose or reason was specified. He also filed an answer, admitting his refusal to allow an inspection as demanded in the absence of

instructions from the president of the corporation, who was absent from the city at the time; and he set up a resolution of the board of directors, adopted after the demand and refusal in this case, instructing him to refuse an inspection of the books "to any agent of a stockholder, unless it is made apparent to him that the stockholder is physically unable to make the examination in person." The court overruled the demurrer, and granted a peremptory mandamus; and this judgment is here assigned as error.

CLOPTON, J. Section 1677, Code 1886, declares: "The stockholders of all private corporations have the right of access to, inspection and examination of, the books, records, and papers of the corporation, at reasonable and proper times." As we do not concur in the proposition that the statute is merely declaratory of the common law, it becomes unnecessary to consider the character and extent of the right of a shareholder, in the absence of statutory regulations, to inspect and examine the books and records of the corporation of which he is a member. The statute was enacted in view of the restrictions and limitations placed by the common law upon the exercise of the right; and the purpose is to protect small and minority stockholders against the power of the majority, and against the mismanagement and faithlessness of agents and officers by furnishing mode and opportunity to ascertain, establish, and maintain their rights, and to intelligently perform their corporate duties. Its terms are clear and comprehensive, and afford narrow room for construction. It was intended to enlarge and disembarrass the exercise of the right, rendering it consistent and coextensive with the stockholder's right, as a common owner of the property, books and papers of the corporation, and with the duties and obligations of the managing officers, as agents and trustees, the only express limitation is that the right shall be exercised at reasonable and proper times; the implied limitation is that it shall not be exercised from idle curiosity, or for improper or unlawful purposes. In all other respects the statutory right is absolute. The shareholder is not required to show any reason or occasion rendering an examination opportune and proper, or a definite or legitimate purpose. The custodian of the books and papers cannot question or inquire into his motives and purposes. If he has reason to believe that they are improper or illegitimate, and refuses the inspection on this ground, he assumes the burden to prove them as such. If it be said this construction of the statute places it in the power of a single shareholder to greatly injure and impede the business,

the answer is, the legislature regarded his interests in the successful promotion of the objects of the corporation a sufficient protection against unnecessary or injurious interference. The statute is founded on the principle that the shareholders have a right to be fully informed as to the condition of the corporation, the manner in which its affairs are conducted, and how the capital to which they have contributed is employed and managed.

It is further contended that, if the petitioner has the right, he cannot exercise it by an agent. The right may be regarded as personal in the sense that only a stockholder possesses and can exercise it, but the inspection and examination may be made by another; otherwise it would be unavailing in many instances. In *Brewer* v. *Watson*, 71 Ala. 299, it was held that an attorney at law, employed by a tax collector to settle his accounts with the auditor, has an interest which entitles him to an inspection of the book in which his client's accounts are entered, but that the auditor may demand evidence of his authority and, on failure or refusal to furnish it, decline to allow the inspection. We perceive no sufficient reason why the same principle should not be extended to an attorney in fact. If a shareholder, who from physical infirmity, or want of skill and knowledge, or other cause, is unable to make a satisfactory and intelligent examination, is debarred the privilege of procuring the aid and services of a competent accountant, the right itself would be worthless—a mockery. In *State* v. *Oil Works Co.*, 28 La. Ann. 204, it is said: "The possession of the right in question would be futile, if the possessor of it, through lack of knowledge necessary to exercise it, were debarred the right of procuring in his behalf the services of one who could exercise it."

In High, *Extr. Rem.*, section 310, speaking of mandamus in cases like the present, it is said: "The writ will not be granted merely to enable a corporator to gratify an idle curiosity in the examination of the corporate records, but he must show some specific interest at stake rendering the inspection necessary, or some beneficial purpose for which the examination is desired. And unless there is some particular matter in dispute between members of the corporation, or between the corporation and its individual members, or some specific purpose for which the inspection is necessary, mandamus will not lie, since the courts will not permit the use of the writ upon merely speculative grounds, or to gratify a spirit of curiosity." We do not assent to the narrow limits to which the jurisdiction is confined in

King v. *Tailor's Co.*, 2 Barn. & Adol. 115; that is, that the inspection must be shown to be necessary in reference to some specific dispute or question pending, in which the parties have an interest. The purpose may be entirely prospective, and an examination would be proper and legitimate, if the object is to obtain information as to the management and condition of the affairs of the corporation, in order to enable the shareholder to determine whether any and what steps are necessary to establish or maintain his rights, or in order to enable him to discharge his corporate duties. *Huylar* v. *Cattle Co.*, 40 N.J. Eq. 392, 2 Atl. 274. Ordinarily, a mandamus will be awarded whenever an inspection and examination are necessary, for any reason, to protect the interests of the stockholders, present or prospective, and is not sought from idle curiosity, or for any improper or unlawful purpose.

The petition merely alleges a demand to inspect at a reasonable and proper time, and a refusal. In my own opinion, the petition should prima facie show a clear legal right to the examination of the books and records; and that a clear legal right is not shown unless the petition not only affirms that the demand was made at a reasonable and proper time, but also negatives that the inspection is sought from a spirit of curiosity, or for an improper purpose, thereby making the demand without both the express and implied limitations upon the statutory right. I am apprehensive that to establish the rule that a shareholder may demand an examination of the books and papers as often as he so pleases, and, on being refused, obtain a writ of mandamus to enforce an absolute right, without being required to exclude all unfavorable intendments by proper averments in the petition, which must be verified, will prove detrimental to the interests of corporations and their stockholders. But the majority of the members of the court competent to sit in this case hold that the statute secures to the stockholder the general right to examine the books at any and all reasonable times. They hold, further, that, when this right is claimed and refused, he is entitled to a mandamus on the averments that he is a stockholder of the corporation, that he has demanded the right of inspection, that the time was reasonable and proper, and that the right was denied him. These averments being made, if there be any reason why the right should not be granted this is a matter of defense. The difference between us relating only to a matter of pleading, and not to any principle involved, I yield to the opinion of the majority.

The result is an affirmance of the judgment.

QUESTIONS

1. What was the extent of a stockholder's right to inspect the books and records of his corporation under the common law? Why has the common-law rule on the subject been generally modified by statute?
2. S, a stockholder of the D Company, made application to its secretary for permission to inspect the stock and transfer books of the corporation. He wished to make a list of all stockholders for the purpose of finding out whether any stock of the corporation was for sale. The secretary refused him permission to inspect the books in question. What are the rights of S against the corporation, if any, under a statute like the one referred to in the principal case?
3. S was a large stockholder and a director in the D Company. He bought ten shares of stock of the X Company, a rival of the D Company, and immediately demanded the right to inspect all the books and records of the X Company. Permission to do so was denied him. He brought mandamus proceedings to secure his alleged right. What decision under a statute like that in the principal case?
4. S brings mandamus proceedings under the statute against the D Company to establish the right to inspect the books and records of the corporation. He alleges and proves that he is a stockholder in the D Company; that he demanded the permission to inspect the books and records of the corporation at a reasonable time; and that permission to do so was denied him. What decision?
5. Does a partner have the right to inspect the books and records of the partnership? What is the extent of the right? How can he establish the right in case his copartners deny its exercise to him?

POOLEY *v.* WHITMORE

57 Tennessee Reports 629 (1873)

BURTON, J. Pooley, Barnum & Co. sued Edwin Whitmore & Co. on two promissory notes for one hundred and eighty-five dollars each, made by W. A. Whitmore, payable at six and nine months respectively, to the order of "Whitmore Brothers" and indorsed in that name. Whitmore Brothers, a firm composed of Edwin Whitmore and the said W. A. Whitmore, were partners in publishing the *Public Ledger*, a newspaper in the city of Memphis, and also conducted a general job-printing office in that city. The notes in suit, however, were drawn and indorsed by W. A. Whitmore in discharge of a private debt that he owed to one Cannon. Edwin Whitmore is the surviving partner of the firm and puts in a special plea of *non est factum*, and insists that the firm is not bound to pay, on the ground that it is not

a partnership debt. Defendants in error reply that they are bona fide purchasers, for value, of the note in due course of trade, and therefore are entitled to recover, notwithstanding the wrong or fraud of W. A. Whitmore in using the partnership name in a personal transaction.

The court below instructed the jury that "as a general rule, one partner is not liable for the act of another partner not within the scope of the partnership business. That if one partner sign a promissory note or other negotiable paper in the firm name, without the knowledge or consent of the other partner, and for a matter not within the scope of the partnership business, the other partner will not be liable unless he ratify the act or unless the paper gets into the hands of some purchaser before maturity, who had no knowledge or notice of the consideration between the original parties, and who paid a valuable consideration for the paper. That such a person would be an innocent holder for value, and without notice." The foregoing instructions are not accurate without important qualifications, and were certainly calculated, as we think, to mislead the jury, in view of the facts of this case.

Every member of an ordinary partnership is its general agent for the transaction of its business in the ordinary way, and the firm is held responsible for whatever is done by any of its partners when acting for the firm, within the limits of the authority conferred by the nature of the business it carries on. Every person is entitled to assume that each partner is empowered to do for the firm whatever is necessary for the transaction of its business, in the way in which that business is ordinarily carried on by other people. But no person is entitled to assume that any partner has a more extensive authority than that above described. It will be observed that what is necessary to carry on the partnership business in the ordinary way is made the test of an authority when no actual authority or ratification can be proved. This is conformable to the most recent and carefully considered decisions, but by adopting it, the liability of a firm for the acts of its copartners is not so extensive as now, lawyers sometimes imagine.

The question whether a given act can or cannot be necessary to the transaction of the business in the way in which it is usually carried on, must evidently be determined by the nature of the business, and by the practice of persons engaged in it. Evidence on both of these points is necessarily admissible, and as readily may be conceived, an

act which is necessary for the prosecution of one kind of business may be wholly unnecessary for the carrying on of another in the ordinary way, consequently no answer of any value can be given to the abstract question: can one partner bind his firm by such an act? Unless having regard to what is usual in business, it can be predicated of the act in question, either that it is one without which no business can be carried on, or that it is one which is not necessary for carrying on any business whatever. There are obviously very few acts of which such an affirmation can be truly made. The great majority of acts which give rise to doubt are those which are necessary in one business, and not in another. Take, for example, negotiable instruments. It may be necessary for one member of a firm of bankers to draw, accept, or indorse a bill of exchange on behalf of the firm, and to require that each member should put his name to it would be ridiculous; but it by no means follows, nor is it in fact true, that there is any necessity for one of several solicitors to possess a similar power, for it is no part of the ordinary business of a solicitor to draw, accept, or indorse bills of exchange. The question, therefore, can one partner bind the firm by accepting bills in its name, admits of no general answer. The nature of the business and the practice of those who carry it on (usage or custom of the trade) must be known before any answer can be given. Lindley on *Partnership*, 198–9–10. It is further said by the same author: "It is clearly settled that any member of an ordinary trading partnership, can bind the firm by drawing, accepting or indorsing bills of exchange or by making and indorsing promissory notes in its name. But with respect to partnerships which are not trading partnerships, the question, whether one partner has any implied authority to bind his copartners by putting the name of the firm to a negotiable instrument, depends upon whether the business of the partnership is such that dealings in negotiable instruments are necessary for its transaction, or are usual in partnerships of the same description. In the absence of evidence showing necessity or usage, the power has been denied to one of several mining adventures, quarry workers, farmers and solicitors." *Ibid.*, 213–14.

The foregoing principles, as we think, have been fully recognized by this court in *Crosthwaite* v. *Ross*, 1 Hump., 23, where the distinction between partners in trade and partners in occupation or employment is taken, and the power of the former class to bind the firm by drawing or indorsing notes and bills, is sustained, while it is denied to the

latter class. It is there held that one partner in the practice of physic could not bind the firm by drawing a bill or making a note on which to raise money, because it was not within the scope of their partnership, and it was distinctly held that the power to raise money was not one of the implied powers resulting from such an association. By recurring to the instructions given by the court below in this case, it will be seen that this important distinction between strictly commercial or trading partnerships, and partnerships in occupation, is entirely ignored, and we think it was the duty of the court to point out the distinction, for prima facie it cannot be said that one partner in a printing office would have the implied power to bind the firm, by drawing or indorsing a note. In this case, to be sure, there was some evidence of the usage of this firm to deal in commercial paper, but there was also evidence tending to the contrary conclusion. The consequence of this distinction between trading and non-trading partnerships is very important in reference to the main defense to be relied upon in this case. If a partner in a banking firm, for instance, should indorse a bill or note for his private debt, and it should get into the hands of a bona fide holder without notice, this firm would be bound by it. The indorsing or making such paper, being the usual mode of conducting that business, the public have a right to suppose that each partner is empowered to accept or indorse for the firm, and are not bound to inquire whether in a given instance the act was done with the assent of his copartners. But not so with a partnership in occupation merely, whose business does not ordinarily require dealing in commercial paper. One who becomes a member of such a firm does not confer implied power on his copartners to bind him by dealing in bills or notes. He is not clothed with apparent power so to bind his firm, and no person dealing with the firm has the right to suppose that the powers of one member are more extensive than is implied by the ordinary mode of conducting such business. If two persons are associated in the practice of law, and one of them, without or against the consent of the other should indorse a note or bill for his private purpose, no one buying such bill could succeed on the plea that he was a bona fide holder without notice. For the reason that by forming such an association the several partners do not hold each other out to the world as empowered to use their names as makers or indorsers of negotiable paper.

The rules, in regard to notice to a purchaser, are very accurately laid down in our own cases, digested in Heiskell, and contain a much

more accurate statement of the law upon the subject than is contained in this charge, and one much more applicable to the facts of the case.

Our conclusion is, that the charge of the court in reference to the facts of this case, if it does not amount to a positive misstatement of the law, was calculated to mislead the jury, and that the appellant is entitled to a new trial, although he failed to ask further instructions to the jury.

On hearing this cause at a former term, the court decided to grant a new trial and it is now before us on application, to reconsider the conclusion at which the court then arrived.

On a reconsideration of the case, we adhere to our former opinion, and reverse the judgment of the municipal court, and remand the cause for a new trial in accordance with the principles herein announced.

QUESTIONS

1. "One partner can bind his copartners by the exercise of implied powers as well as by express powers." What is the difference between express and implied powers? What powers will in general be implied? Why do partners leave any of their powers to implication?
2. Suppose that a partner without express or implied authority purports to make a contract for the firm, what is the effect of the contract? Is there any way in which the firm can take advantage of the unauthorized agreement?
3. What error did the trial court in the principal case commit in giving instructions to the jury? How should the court have instructed the jury?
4. A and B are partners, engaged in the practice of medicine. A signs a note in the firm name and delivers it to P in payment of his own debt. H, a holder in due course, sues on the note. What decision?
5. A and B are partners engaged in a retail clothing business. A executes a firm note and delivers it to P in payment of a gambling debt. What are the rights of H against the firm on the note?
6. A and B are engaged as partners in a banking business. H is holder in due course of a firm note executed by B in payment of his own debt. What are H's rights on the note?
7. A and B operate a farm. A borrows money from P on the credit of the firm for his own use. P sues the firm for money so advanced. What decision?

LEFFLER *v.* RICE

44 Indiana Reports 103 (1873)

DOWNEY, C. J. The appellee sued the appellants for work and labor, for money loaned, money had and received, for board and lodging, and for wood, provisions, and merchandise, a bill of particulars of which was filed with the complaint. The defendants answered in three paragraphs: (1) A general denial; (2) payment; (3) set-off. Reply in denial of the second and third paragraphs of the answer. Trial by the court, finding for the plaintiff, motion for a new trial overruled, and final judgment for the plaintiff.

The only errors properly assigned are the overruling of the motion for a new trial, and the taxing of a reporter's fee for taking down the evidence in the case against the defendants, as part of the costs of the case.

The grounds for a new trial are the following: (1) Because the finding and judgment thereon are contrary to the evidence; (2) because of errors of law occurring during the trial of said cause, in the ruling of the court as to the admissibility of evidence excepted to at the time; (3) because of errors of law in the ruling of the court arising on the pleadings in said cause, and excepted to at the time.

The principal question made with reference to the evidence is, that it fails to show that the indebtedness for which the judgment was rendered was an indebtedness of both of the defendants. They are charged as partners, and it is insisted that, although the evidence may show a liability on the part of Rice, one of the defendants, it fails to show that Leffler, the other defendant, was liable with him as a partner. In other words, it is claimed that the indebtedness was the indebtedness of Rice alone, and not of the firm. It is also insisted that, assuming that the indebtedness was that of the firm, the same had been paid before the action was brought.

During the progress of the trial, the plaintiff admitted the account of the defendant filed with his answer of set-off, and it was mutually agreed that the only matters then in issue were a certain sum of two hundred dollars, called the Eller money, three hundred and fifty dollars of Allen money, the money taken to pay for middlings, and the pay which the plaintiff might be entitled to for such purchases as he had made for the mill of the defendants.

After a careful reading and analysis of the evidence, we have come to the conclusion that we cannot disturb the judgment below on the

evidence. It is true that Leffler, one of the defendants, testifies pretty strongly against his liability as a member of the firm; but it appears that he was much of the time absent from the place of business, and that Rice, his partner, at those times, transacted the business exclusively, and that he always kept the books of the concern. It also appears that Leffler knew so little about the affairs of the concern, that it was not until he got an account taken by an accountant, that he was aware of the fact that his partner, Rice, had overdrawn to an amount exceeding a thousand dollars. Little weight can, therefore, be given to his statements to the effect that he did not know that the firm owed the amounts in question.

Rice, the appellant, is a son of the appellee. There seems to have been a sharp contention between them concerning the disputed accounts amounting even to violence on one occasion. Their testimony is quite conflicting on the material points of the case.

It is urged as a question of law that Rice, one of the defendants, could not bind Leffler, his partner, for the items in question, for the reason that they were foreign to the business of the firm. Two of the items claimed by the appellee were for money loaned, one was for money paid for middlings, and one was for services in the purchase of grain, etc. The business of the defendants was that of milling. We do not see that the items of indebtedness are such as might not properly and reasonably have accrued in connection with the business. We are aware of the rule of law stated by counsel for appellants, that where a person takes a security from one partner in the name of the partnership, in a transaction not in the usual course of dealing, he takes the security at his peril. Money may properly be borrowed by a partner to be used in the business of milling by the firm. The evidence of the plaintiff tends to show that the middlings in question were purchased to be ground over at the mill of the defendants, which would seem to be properly connected with the business of milling; and as to the compensation for purchasing grain for the mill, there cannot well be any question. The items of these classes, which the evidence of the plaintiff tended to establish, amount to more than the sum of the judgment.

The judgment is affirmed, with costs.

QUESTIONS

1. What were the claims against the firm for which this action was brought? Did Rice have express authority to bind the firm for these things? If not, why was the firm held liable for them?

2. A and B are partners in the retail grocery business. A, without express authority, buys fifty hams from P for the business. P brings an action against the firm for the price of the hams. What decision?
3. In the foregoing case, A borrows five hundred dollars from P with which to pay for sugar for the firm. P sues the firm for the amount so advanced. B contends that the firm is not liable because A had no authority to borrow the money. What decision?
4. C and D are engaged in the jewelry business as partners. C without the knowledge or consent of D bought ten diamond rings from P on the firm credit, immediately sold the rings and absconded with the money. P sues the firm for the price of the rings. What decision?
5. M and N are partners in the retail hardware business. M buys a heater from P, telling P that it is for his own home. P brings an action against the firm for the price of the heater. What decision?
6. Would your answer be the same in the foregoing case if A had decided not to use the heater in his home and had turned it over to the firm business?

TAPLEY *v* BUTTERFIELD

1 Metcalf's Massachusetts Reports 515 (1840)

Trespass *de bonis asportatis*. The plaintiff claimed title to the goods under a mortgage made to him as hereinafter stated. The defendant admitted the taking of the goods, and justified under a writ by virtue of which he, as deputy sheriff, attached the same in suit by P. and B. S. Hale against the firm of A. and W. A. Blaisdell.

At the trial before PUTNAM, J., it was proved, that said firm was indebted to the plaintiff in the sum of $650, and that A. Blaisdell, one of the partners, in the absence of the other partner, and without his knowledge, executed to the plaintiff a mortgage of the goods in question, being the whole stock in trade of the firm. The separate names of each partner were several times recited in the mortgage, as conveying the goods to the plaintiff, and the instrument concluded with these words: "In witness whereof, I, the said Alvah & William A. Blaisdell, have hereunto set our hands and seals this 24th day of May, 1839." One seal only was affixed.

W. A. Blaisdell testified that if he had been present when the mortgage was given, he should not have executed it.

The goods were sold by the defendant, on the writ, by consent of parties, on the next day after they were attached. But the plaintiff did not demand payment of the money due to him, and state in writing an account of the debt for which said goods were liable to him, until thirteen days after the sale.

The defendant's counsel objected to the plaintiff's right to recover, on the ground that said mortgage was not valid. The judge overruled the objection, and a verdict was returned for the plaintiff, subject to the opinion of the full court.

SHAW, C. J. If it were necessary, in order to maintain the validity of the mortgage under which the plaintiff claims, to hold that one partner has a general power to bind his copartner by deed, it would certainly be difficult to maintain that proposition. The general rule is, that he cannot. *Cady* v. *Shepard*, 11 Pick. 400. And in a case where the question is, whether one partner can by his general authority, growing out of the relation of partners, execute a deed in the name of both, in such form as to pass real estate belonging to them as partners, or to render them liable to an action of covenant, I should be strongly inclined, upon the authorities, to think that he could not. But that rule does not decide the present case.

We are not aware that a mortgage of personal property requires a deed. If an act be done, which one partner may do without deed, it is not the less effectual, that it is done by deed. It is clearly within the scope of partnership authority (I speak of a partnership between merchants, the object of which is the buying and selling of goods) for one partner to sell such goods as have been purchased for sale. Supposing then a customer, purchasing for some special purpose of his own, should, instead of a sale by parol, or a common bill of parcels, or a bought and sold note, choose to have a formal bill of sale under seal, in the name of the firm, and such bill should be executed by one of the partners; though the firm might not be liable to an action on the special covenants, yet the property would pass. And although the bill of sale should purport to be the act of both, it would not be the less the act of him who made it; and as his act would be sufficient to pass the property, it would not be less available because the name of his partner was added in such a form as to be inoperative.

Then treating this as the efficient act of one partner, in giving a mortgage upon the partnership property for the security of a partnership debt, is it sufficient to bind the property?

It is within the general scope of partnership authority for one partner to sell and dispose of all the partnership goods, in the orderly and regular course of business. It is also within the scope of partnership authority to pay the debts of the firm, and to apply the assets of the firm for that purpose. He being authorized to sell the goods to

raise money to pay their debts; he may apply the goods directly to the payment of the debts; and, according to the exigencies of the occasion, he may pledge the partnership goods to raise money to pay the debts of the firm. To this extent we think each partner has a disposing power over the partnership stock, arising necessarily from the nature of that relation. If it were in the form of a consignment to a commission merchant or an auctioneer, and an advance of money obtained for the use of the firm, we think there could be no question but that it would be within the scope of partnership authority. And now that the law has given encouragement to mortgages of personal property—which is only another mode of pledging goods—and has substituted an instrument in writing capable of being recorded in the town clerk's book, and has given to such record an effect equivalent to the actual delivery of the goods (*Bullock* v. *Williams*, 16 Pick. 33), we cannot perceive why it may not be resorted to by partners, as well as individual persons. To what extent one partner can bind another, in the disposition of the entire property of the concern, is a question of power, arising out of the relation of partnership, and does not, we think, depend upon the form or manner in which it is exercised. Lands held by partners are considered as lands held by tenants in common; and as one tenant in common cannot pass any estate of his covenant, and as land cannot pass without deed, it follows that one partner cannot convey away the real estate of the firm, without special authority.

But considering that the authority of selling and pledging the personal property is within the scope of partnership power, and may be done by either partner; and considering, that it may be done without deed; the court is of opinion that such a mortgage, made by one partner in the absence of the other, although unnecessarily made by deed, was binding upon the property, and constituted a valid lien upon the property, of which the plaintiff may avail himself. *Anderson* v. *Tompkins*, 1 Brock. 456; *Deckard* v. *Case*, 5 Watts, 22.

Judgment on the verdict.

QUESTIONS

1. What is the extent of the authority of a partner to dispose of the stock in trade of his firm?
2. A and B are engaged in the grocery business as partners. A, without express authority, sells the cash register of the firm to P. The firm brings an action to recover possession of the property. What decision?

3. A pledges the cash register with C to secure a debt which the firm owes to C. The firm sues to recover possession of the property. What decision?
4. W, without the knowledge or consent of B, placed a chattel mortgage on the stock in trade of the firm to secure the debt of C. Discuss the validity of the mortgage.
5. A without B's consent executes and delivers a deed to P purporting to convey the land and building belonging to the firm. P brings an action against the firm for possession of the property. What decision?
6. C and D are partners engaged in the business of buying and selling realty. They acquire joint title to a tract of land which they intend to resell later on. C without D's consent purports to convey the land to P. Discuss the validity of the conveyance.
7. In the foregoing case, C enters into a contract to sell the land to P. P brings an action against the firm for its refusal to sell the land. What decision?
8. C holds title to a piece of firm realty. Without B's consent he makes and delivers a deed to P purporting to convey the land in question. What is the effect of the conveyance?

MAJOR *v.* HAWKES

12 Illinois Reports 298 (1850)

The defendants in error sued Major, in the McLean Circuit Court, to recover an indebtedness due to them as copartners. Major proved the payment of his indebtedness to Hawkes, one of the copartners, after the publication of a notice of dissolution, by mutual consent. A verdict was found on the circuit, against Major, and he brings the cause to this court by writ of error. The cause was heard before DAVIS, J.

TRUMBULL, J. Upon the voluntary dissolution of a partnership, each of the partners, in the absence of any agreement to the contrary, retains the right to collect debts due the firm, and give discharges therefor. Story on *Partnership*, section 328.

Hawkes had, therefore, just as much right to receive the money from Major, and give the receipt of the firm, as either of the other partners and the receipt, if honestly obtained, was a defense to the further prosecution of the action. The fact, that Major first made an attempt to settle the account by giving Hawkes credit upon a claim which he had against him individually, did not prevent him from afterward paying the money to Hawkes, when he ascertained

that the other partners would not assent to the first arrangement. Major was not responsible for the application which Hawkes made of the money, so that he paid it in good faith, nor does the insolvency of Hawkes, at the time, alter the case. The record shows, that he was known by the other partners to have been insolvent when the partnership was formed. They were willing to trust him, notwithstanding, and by becoming his partners, gave to him the same right to receive the debts, that should become due the firm which either of them should possess. It is true, that without the assent of his copartners, he had no right to apply partnership effects in discharge of his individual indebtedness, and a creditor of his, knowingly receiving such effects in discharge, would be responsible for the same to the firm.

To deprive Major of the benefit of the payment made to Hawkes, it was incumbent upon the plaintiffs below, to show that it was made in good faith. It has been suggested by counsel, that the money was returned to Major, after being paid over, but there is no evidence in the case to justify such a presumption. The witness to the receipt testifies that the money was paid over to Hawkes in his presence, and this is all the evidence in the record about the money. For aught that appears, Hawkes may have accounted with his copartners for the money received from Major, but whether he has or not, is quite immaterial to Major, provided he honestly paid the money, and has in no way aided or abetted in the misapplication of it. There would be no safety in paying a partnership debt to a single member of a firm, if the debtor was bound to see that the money was properly applied by the partner receiving it.

The judgment of the circuit court is reversed and the cause remanded.

Judgment reversed.

QUESTIONS

1. When a firm for any reason is dissolved, who has the power to settle the partnership affairs?
2. A, B, and C mutually agree to dissolve the firm theretofore existing between them. A, after dissolution, (*a*) pays a firm debt to X, (*b*) receives from Y a debt which Y owes to the firm, and (*c*) sells the remaining stock in trade to Z. Discuss the validity of each transaction.
3. After dissolution B executes a promissory note in the firm name and delivers it to E in payment of a firm obligation. E sues A, B, and C on the note. What decision?

4. At dissolution the firm holds two unmatured promissory notes. C transfers one of the notes by a general indorsement to P and the other by a qualified indorsement to Q. Discuss the validity of each transaction.
5. M, N, and O are members of a partnership engaged in the grocery business. O dies. What are the powers of M and N in closing up the partnership affairs?

c) Powers of Representatives

HUTCHINSON *v.* GREEN

91 Missouri Reports 367 (1886)

Black, J. This case is an outgrowth of *Ward* v. *Davidson*, 89 Mo. 445. By the decree rendered in that case certain directors of the Keokuk Northern Line Packers Co. were removed from office. Thereafter, and at a special election held on the seventeenth of November, 1880, pursuant to the order of the circuit court, four directors were elected to fill the unexpired term of the removed directors. There had been a disagreement of long standing between the officers and stockholders as to the management of the affairs of the company, which resulted in two parties, one known as the Davidson, or majority party, and the other as the Gray, or minority party; the removed directors were of the former. By cumulative voting at the special election the minority party elected a sufficient number of directors to give them a majority in the board for the time being. On the fifteenth of January, 1881, and four days before the annual election of directors, notice of which had been given, the board resolved to, and did, make a voluntary assignment of all of the property of the company for the benefit of all of the creditors. At the annual election the majority party again acquired the ascendency in the board, and the plaintiffs then, for themselves, and other stockholders brought this suit against the directors who voted for the assignment. They allege that the defendants combined to destroy the property and business of the corporation, and in furtherance thereof made the assignment, and pray that the deed of assignment be set aside for the alleged fraud, for other equitable relief, and for damages.

The defendants, in making the assignment, acted in part, at least, upon a report made by a committee appointed to examine into the affairs of the company. That report clearly enough shows that the company was unable to pay its debts in the usual course of business. But the correctness of that report was then, and is now,

denied. The new board caused another report to be made, by a new committee, in which the debts are placed at $161,944.07, and in this respect the two reports are not materially different. In the last, the effects are valued at $234,229.35; thus leaving a surplus over liabilities of $72,285.62. No account is taken of capital stock, amounting to $751,000, paid in full. The evidence as to the value of the assets is conflicting and unsatisfactory; many of the witnesses having but little knowledge of the property about which they testified. In the last report warehouses are placed at $47,197.87, and cash and bills receivable appear to be estimated at $9,000 or $10,000. The evidence shows that the warehouses were poor affairs, scattered along the river from St. Louis to St. Paul, on property not owned by the company, and were of no greater value than $18,000. The bills receivable were of little value, and the company had no money on hand worthy of mention. The best steamboats, barges, and wharf-boats were mortgaged to at least $47,000. Some of the boats and barges were wrecks, all were out of repair, and to put them in repair would require an outlay of $40,000. New boats and barges were required to carry on the former business of the company. The loss in business for 1880 had been $60,000. Suits were pending against the company for large amounts. These plaintiffs and those acting in concert with them had, at the date of the assignment, begun suits against the company amounting to $90,000, some commenced in foreign jurisdictions by attachment. From the evidence, as a whole, we conclude the entire property of the company was not worth more than $190,000 under the most favorable circumstances, and as a means of raising ready money, it was not equal to the debts. In short, it is clear the corporation was insolvent, and wholly unprepared to enter the spring trade.

On the other hand, the defendants, as directors, voted for and caused the assignment to be made in opposition to the known and expressed will of a majority of the stockholders. They knew their power to control the affairs of the corporation must cease at the coming election, only four days distant. They also agreed among themselves to make the assignment before presenting the matter openly at a meeting of the directors, and then they had a deed previously prepared, with a notary public at hand to take the acknowledgment as soon as the resolution should be passed. Any inferences of fraud which might be drawn from these circumstances if they stood alone is overcome by the other facts in the case; for the defendants

knew that the affairs of the corporation were growing from bad to worse. They saw the efforts of the plaintiffs, and those acting with them, to appropriate the property of the company to the payment of their debts, in disregard of the other creditors. Enough has been said to show that the Packet Co. was in no condition to prosecute its business—was insolvent. Under these circumstances, the directors, having a due regard for the creditors in general, could not do otherwise than make an assignment. The alleged fraud, we conclude, is not proved, but clearly disproved.

It is further insisted that the board of directors had no power to make the assignment without the consent of the stockholders. A corporation may, like an individual, make an assignment under the statute of this state relating to voluntary assignments. *Shockley* v. *Fisher*, 75 Mo. 498. By whom, then, is the power to be exercised? By the directors, the stockholders, or by both? Where the powers of a corporation are vested in a board of directors, they may, unless restricted, do whatever the corporation might. Field on *Corporations*, sections 146 and 152. Now, while, by express statute, a vote of the stockholders of these corporations is essential to enable them to increase or diminish the stock, to change the business, to issue preferred stock, and to convert bonds into stocks, still, in general, article 8, of chapter 21, Revised Statutes, contemplates that the business will be conducted by a board of directors. Section 930, among other things, provides that "the property or business of the corporation shall be conducted and managed by directors." Certain it is there is nothing in the statute under which the corporation was created, and by which it is governed, or in its articles of association, or by-laws, which limits or restricts the powers of the directors in the disposition of the property. The corporation then has the power to make an assignment, and that power being vested in the directors without restriction, it must follow that they, and they alone, are authorized to make it. It is the duty of the directors to care for the creditors, and when the corporation becomes crippled and unable to meet its obligations in the usual course of business, it is competent for the directors to make an assignment, and this they may do without the consent of the stockholders. This conclusion has the support of adjudications of this and other courts. *Chew* v. *Ellingwood*, 86 Mo. 260; *Dana* v. *The Bank of the United States*, 5 W. & S. (Pa.) 223; *DeCamp* v. *Alward*, 52 Ind. 473. The directors may, with propriety, consult with the stockholders, but under the circumstances

just stated and in the exercise of their best judgment, they may make the assignment even against the expressed will of the stockholders. Of the cases relied upon by the appellants that of *Abbot* v. *American Hard Rubber Co.*, 33 Barb. 580, was not an assignment for the benefit of creditors. There the trustees attempted, through the form of a sale, to secure to themselves the property of the corporation at the expense of the other stockholders. The sale was voidable, as to the stockholders not consenting, though a majority agreed to the transaction.

No question of the validity of a voluntary assignment of an insolvent corporation, made for the benefit of the creditors, was involved in the case. The same may be said of *Northern Railroad* v. *Concord Railroad*, 50 N.H. 175, for there the purpose of the contract, brought in question, was to transfer the management of the affairs of one company to the other for a period of five years. The assignment was upheld in *Eppright* v. *Nickerson*, 78 Mo. 482, though the stockholders did not authorize or assent to it. In that case the assignment was not assailed by any stockholder, and the court, by way of concession, made some remarks which seem to imply that consent on the part of the stockholders is essential to give validity to an assignment as against them, but as to these remarks, enough was said in *Chew* v. *Ellingwood*, *supra*.

The judgment of this case is, therefore, affirmed.

QUESTIONS

1. How are the directors of a corporation elected? How many are elected? Must a director be a stockholder in the corporation? Can they be removed from office? If so, for what causes and how are they removable? Are directors of a corporation entitled to compensation for their services?
2. In general what powers are possessed by directors in the management of the affairs of a corporation? What are the sources of the powers of directors?
3. The charter of the D Company vests the management of the corporation in a board of directors to be elected annually. The directors without consulting the stockholders take the following actions: (*a*) they borrow money on the credit of the corporation with which to extend the business; (*b*) they execute a mortgage on the real and personal property to secure a debt of the corporation; (*c*) they sell a part of the corporate property with which to pay a corporate debt. Discuss the validity of each transaction.

4. The directors take the following actions without consulting the stockholders: (*a*) they accept an amendment to their original charter giving the corporation new powers; (*b*) they increase the capital stock, (*c*) they decrease the capital stock; (*d*) they consolidate the corporation with X Company; (*e*) they sell all the property of the corporation with a view to going out of business. Discuss the validity of each transaction.
5. What rule does the cause of *Hunter* v. *Roberts*, *supra*, page 422, lay down with respect to the power of the directors in declaring dividends?
6. What rule does the case of *Morton Gravel Road Co.* v. *Wysong*, *supra*, page 505, announce with respect to the power of directors in the making of by-laws?

THE FIRST NATIONAL BANK OF FORT SCOTT *v.* DRAKE

35 Kansas Reports 564 (1886)

JOHNSTON, J. This case can be easily disposed of. The only question presented arises upon the refusal of the court to enter judgment in favor of the plaintiff upon the findings of the jury for the amount of money taken from the bank by the defendant as interest on demand certificates of deposits that had been issued to himself while he was serving as president and cashier of the bank. The defendant admits that he took the money at the times and in the amounts charged by the plaintiff, and the jury have found that during all the time the defendant was acting as an officer of the bank, there existed a rule or by-law of the bank which prohibited the payment of interest on demand certificates of deposit, and that at no time while the defendant was an officer of the bank did he ever inform the board of directors that he had taken interest on these certificates; and it was also found that the directors did not at any meeting of the board authorize or ratify the action of the defendant in taking interest. The defendant contended and contends that although his act in taking the money was contrary to the by-laws of the bank, yet that there had been a ratification of the unauthorized act by the board of directors which is binding upon the bank. After stating that the directors had never at any meeting of the board ratified the taking of interest by the defendant, the question was asked the jury: "Did the board of directors at any time ratify the taking of the several amounts of interest?" To this question an affirmative answer was given; but in the next finding the jury explained particularly how the supposed ratification had been made, finding that it was "by

individual consent of a majority of the board." The last finding, stating particularly what was done, controls and prevails over the former one stating the general conclusion that there had been a ratification. These findings clearly show that the only sanction which the unauthorized acts of the defendant have received from the plaintiff, was given by the individual members of the board acting singly and separately, and not as a board. Action thus taken is not binding on the bank, and does not constitute a defense to the plaintiff's claim. The statute declaring the methods in which the bank may exercise corporate power provides that the appointment and dismissal of its officers, the enactment of by-laws regulating the manner in which its officers and agents shall conduct its business, and the general supervision and management of its affairs, shall reside in and be exercised by a *board* of directors. (Rev. Stat. U.S. sec. 5136.) This statute provides for the election of a president of the board, and otherwise assures that the directors shall act unitedly as an organized body. The election of an individual as a director does not constitute him an agent of the corporation with authority to act separately and independently of his fellow-members. It is the board duly convened and acting as a unit that is made the representative of the company. The assent or determination of the members of the board acting separately and individually is not the assent of the corporation. The law proceeds upon the theory that the directors shall meet and counsel with each other, and that any determination affecting the corporation shall only be arrived at and expressed after a consultation at a meeting of the board attended by at least a majority of its members. As the only powers conferred upon directors are those which reside in them as a board and when acting collectively as such, the individual consent of a majority of the members acting separately is not enough to ratify the unauthorized appropriation of the money of the bank by the defendant. (Angell and Ames on *Corporations*, sec. 504, *et seq.;* Morawetz on *Private Corporations*, sec. 247; *First National Bank* v. *Christopher*, 11 Vroom, 435; *D'Arcy* v. *Tamorac Ry. Co.*, Law Rep. 2 Exc. 158; *Edgerly* v. *Emerson*, 3 Foster, 555; *Stoystown & Greensburg Turnpike Road Co.* v. *Craver*, 45 Pa. St. 386; *Keeler* v. *Frost*, 22 Barb. 400.)

The conclusion which we have reached renders it unnecessary to consider the other questions so much and so well argued by counsel with regard to the relations existing between the cashier and the board of directors, and which both of them sustain toward the bank,

and whether the doctrine of ratification can have application to a transaction wholly between the board of directors and the cashier.

The ruling of the district court disallowing the plaintiff's motion for judgment *non obstante veredicto* will be reversed, and the cause remanded with directions to enter judgment on the special findings of the jury for the additional amount appropriated by the defendant without authority of the bank as interest on demand certificates of deposit, in accordance with the plaintiff's application.

All the justices concurring.

QUESTIONS

1. What constitutes a quorum for a directors' meeting? Is a director entitled to vote at a directors' meeting by proxy?
2. Can the directors bind the corporation by actions taken at a meeting held in a state other than the state in which the corporation was organized?
3. If all the directors individually and informally assent to some action of the corporation or its agents why is the corporation not bound by the action?
4. X, one of the directors of the D Company, executes a mortgage on corporate property in favor of C, a creditor of the corporation. What decision in proceedings brought to foreclose the mortgage?
5. In the foregoing case, C offers evidence tending to show that before the mortgage was executed he consulted the other directors and that they informed him that X had the authority to execute the mortgage. What decision in proceedings to foreclose the mortgage?

CHICAGO AND NORTHWESTERN RAILWAY COMPANY *v.* JAMES

22 Wisconsin Reports 194 (1867)

DIXON, C. J. The court instructed the jury, "that if P. H. Smith is a director or vice-president of the company, and, in point of fact, in the actual charge of the lands of the company appointing agents to protect them from trespass, or to sell the lands or timber, as they shall be advised, and the jury in the absence of testimony, may presume that Smith had authority to the extent to which he assumed to act." The language of the instruction is somewhat inaccurate and ambiguous, and there are doubtless some mistakes either with the writer or printer. The words "and the jury" at the beginning of the last clause probably should read "then the jury." But with this correction, the ideas of the judge are not very clearly

expressed. As we understand the instruction, however, it was in substance, either that Mr. Smith as director or vice-president of the company, had power, ex officio, to take charge of the lands, and to appoint agents to protect them from trespasses, or to sell them or the timber, as they might be advised; or else, that being such director or vice-president, without such power ex officio, yet if he assumed to have it and did take actual charge of the lands and appoint agents to protect them from trespasses, or to sell them or the timber, the jury might presume, in the absence of testimony, that he had authority to the extent to which he thus assumed to act. Neither proposition is in point of law correct. We are not informed as to what the peculiar powers or duties of a director or vice-president of this company may be by its charter, nor do we care to examine. It is enough that no such extraordinary powers are claimed or shown to have been conferred by the charter. We assume that a director possesses the powers usually given in such cases, and that he is authorized to act as a member of the board in all matters touching the business concerns of the corporation and the management of its affairs; but that, when not acting as a member of the board, he had no authority to represent the corporation, or to bind it by his acts, unless authorized by some proper action of the board, in which case he acts precisely like any other agent of the corporation, and upon the same authority. And so, too, of the vice-president. We consider, that his duty, in addition to that imposed upon him as director, is to preside at meetings of the board in the absence of the president. The principles with regard to the general powers and duties of such officers are elementary. In *Walsworth County Bank* v. *Farmers' Loan and Trust Co.*, 14 Wis., 325, it was held by this court that the president of a railroad company had no power, by virtue of his office merely, to make a sale of the property of the company; and his is certainly an office of more dignity and importance than that of a vice-president or director. See that case, and the authorities there cited, and also Angell and Ames on *Corporations*, sections 299 to 302, inclusive.

As to the other proposition, its incorrectness is manifest from what has already been said. If Mr. Smith had no ex officio power, then his authority as agent must be shown by some competent testimony, the same as that of any other agent; and it cannot, in the absence of testimony, be presumed from the mere fact that he assumed to act as agent. Such authority may be shown in various ways: as by resolution of the board of directors; or by verbal appointment

under their authority, or with their approbation; or by proof that Mr. Smith took actual charge of the lands, and did appoint agents to sell them, or the timber, with the knowledge of the directors, who tacitly acquiesced or took no action to prevent it. These, or some such evidence of authority, must be given before the company can be bound. The mere facts that Mr. Smith was director or vice-president and did the acts, are not sufficient. Previous authority must be shown, or actual knowledge of the transactions must be brought home to the directors. The case of *Bridgeport Bank* v. *New York & New Haven Railroad Co.*, 30 Conn., 231, is inapplicable, for the reason that there the act complained of was the act of an actual agent of the company, acting within the scope of his official power. The same observation may be made of several of the other cases cited by counsel for the defendants. The rule in such cases is, that corporations, like natural persons, are bound, and bound only by the acts and contracts of their agents done and made within the scope of their authority.

As the judgment must for these reasons be reversed, and a new trial awarded, it becomes unnecessary for us to examine any of the other numerous exceptions noted in the bill.

QUESTIONS

1. From what source or sources do the various officers and agents of a corporation derive their powers?
2. What powers does the president of a corporation possess by virtue of his office? What powers are usually conferred upon him by the corporation?
3. What powers are usually conferred upon the vice-president? upon the secretary?
4. What powers does the treasurer of a corporation possess by virtue of his office? What powers are usually conferred upon him by the corporation?
5. The directors of a corporation, acting under authority, vest the management of the corporation in a general manager. What powers does this officer possess by virtue of his office?
6. Does a partnership have officers comparable to those of a corporation? Does a partnership conduct its affairs through agents as a corporation does?

3. Duties of Members and Representatives in Management

SMITH *v.* HURD

12 Metcalf's Massachusetts Reports 371 (1847)

This was a special action on the case, by a stockholder of the Phoenix Bank, against those who were directors of the said bank, for several years next before and at the time of the failure of said bank, in October, 1842. There were two counts: one founded in non-feasance of official duty and the other in misfeasance.

The defendants demurred to the declaration, and the plaintiff joined in demurrer.

SHAW, C. J. This is certainly a case of first impression. We are not aware that any similar action has been sustained in England, or in any of the courts of this country. It is founded on no statute. It is an action on the case, at common law, brought by an individual holder of shares in an incorporated bank, against the directors, not including the president, setting forth various acts of negligence and malfeasance through a series of years, in consequence of which, as the declaration alleges, the whole capital of the bank was wasted and lost, and the shares of the plaintiff became of no value. The circumstance that no such action has been maintained would certainly be no decisive objection, if it could be shown to be maintainable on principle. But the fact, that similar grievances have existed to a great extent, and in numberless instances where such an action would have presented an obvious and effective remedy, affords strong proof, that in the view of all such suffering parties, and their legal advisers and guides, there was no principle on which such an action can be maintained.

If an action can be brought by one stockholder, it may be brought by the holder of a single share; so that for one and the same default of these directors, thirty-five hundred actions might be brought. If it may be sustained by proof of an act, or series of acts, of carelessness, neglect, and breach of duty in managing the affairs of the bank, by which the whole value of the stock is destroyed, it may, on the same principle, be maintained on any act or instance of such negligence, by which the shares are diminished in value, 50, 10, 5, or 1 per cent. Still, notwithstanding these consequences, if the plaintiff has a good right of action, upon recognized and sound legal principle his action ought to be sustained.

But the court is of opinion that the action cannot be maintained and that on several grounds, a few of the more prominent of which may be alluded to.

1. There is no legal privity, relation, or immediate connection between the holders of shares in a bank, in their individual capacity, on the one side, and the directors of the bank on the other. The directors are not the bailees, the factors, agents, or trustees of such individual stockholders. The bank is a corporation and body politic, having a separate existence as a distinct person in law, in whom the whole stock and property of the bank are vested, and to whom all agents, debtors, officers, and servants are responsible for all contracts, express or implied, made in reference to such capital, and for all torts and injuries diminishing or impairing it. The very purpose of incorporation, is to create such legal and ideal person in law, distinct from all the persons composing it, in order to avoid the extreme difficulty of such a number of persons acting together in their individual capacities. The practical difficulty would be nearly as great whether it were held that all must join in an action to recover damage for an injury to the common property, or that each might sue separately.

The stockholders do, indeed, ordinarily elect the directors; but it is as parts and members of the corporation, in their corporate capacity, in modes pointed out by the charter and by-laws, so that the directors are the appointees of the corporation, not of the individuals. Indeed, I believe there is a provision in the bank charters—there certainly was formerly—which is equally to the present purpose; namely, that the Commonwealth shall be at liberty to add a certain amount to the capital of various banks, and appoint a proportional number of directors. Such directors, so appointed, pursuant to the charter regulating the legal organization of the body, would stand in all respects on the footing of directors chosen by the stockholders. If these were liable to the action of individual stockholders, those would be in like manner.

2. The individual members of the corporation, whether they should all join, or each act severally, have no right or power to intermeddle with the property or concerns of the bank, or call any officer, agent, or servant to account, or discharge them from any liability. Should all the stockholders join in a power of attorney to anyone he could not take possession of any real or personal estate, any security or chose in action; could not collect a debt or discharge a claim, or

release damage arising from any default; simply because they are not the legal owners of the property, and damage done to such property is not an injury to them. Their rights and their powers are limited and well defined. They are members of an organized body, and exercise such powers as the organization of the institution gives them. Stockholders in banks have a separate right to dividends, when declared, and to a distributive share of the capital stock, if any remains when the charter of the bank is at an end, and its debts paid.

3. But another important consideration is, that the injury done to the capital stock by wasting, impairing, and diminishing its value, is not, in the first instance, nor necessarily, a damage to the stockholders. All sums which could, in any form, be recovered on that ground, would be assets of the corporation, and when collected and received by directors, receivers, or any other persons entitled to receive the same, they would be held in trust, first to redeem the bills and pay the debts of the bank; and it would be only after these debts were paid, and in case any surplus should remain, that the stockholders would be entitled to receive anything. It is, therefore, an indirect, contingent, and subordinate interest, which each stockholder has, in damages, so to be recovered against directors. If, upon such indirect, contingent, and remote interest, individual stockholders could recover for the defaults of directors, and especially, as is alleged in this case, where the defaults have been so great as to sink the capital, *a fortiori* would the creditors of the bank individually have a right to maintain similar actions; because their claim upon the funds, being prior to that of stockholders, would be somewhat more immediate and direct. In the same connection it is obvious to remark, that a judgment in favor of one stockholder would be no bar to an action by a creditor, nor a judgment by both, to an action by the corporation.

4. But it is said, that although the real and personal estate, the securities and capital stock, are, in legal contemplation, vested in the corporation, yet the individual has a separate and distinct property and interest in his particular shares, by any injury to which he may have a separate damage. To some extent, it is true that he has a several interest in his shares; but it is to be taken with some qualifications. Strictly speaking, shares in a bank do not constitute a legal estate and property; it is rather a limited and qualified right which the stockholder has to participate, in a certain proportion, in the benefits of a common fund, vested in a corporation for the common use;

it is a qualified and equitable interest, a valuable interest manifested usually by a certificate, which is transferable. To the extent of this separate and peculiar interest, a stockholder, no doubt, might maintain his separate and special action, according to the nature of the wrong done to him in respect to it; as trover or trespass, for the conversion or tortious taking of his certificate; trespass on the case for refusing to make a transfer on a proper occasion; assumpsit for a dividend declared and the like. But an injury done to the stock and capital, by negligence or misfeasance, is not an injury to such separate interest, but to the whole body of stockholders in common. It is like the case of a common nuisance, where one who suffers a special damage, peculiar to himself and distinguishable in kind from that which he shares in the common injury, may maintain a special action. Otherwise, he cannot. Co. Lit. 56a; 3 Steph. N.P. 2372; *Lansing* v. *Smith*, 8 Cow. (N.Y.) 146.

But we are pressed with the argument, that for every damage which one sustains, which is caused by the wrongful act of another, he ought to have a remedy. This is far from being universally true. Another maxim in regard to claims for damage is, *causa proxima, non remota, spectatur*. Thousands of instances occur, in which one sustains consequential and incidental damage from the misconduct of another, without a remedy at law. By the misconduct of the officers or agents of a parish, town, county, or even of the state or the Union defalcations may take place, treasure be squandered and wasted, and all the members of the respective aggregate bodies suffer damage, for which the law, from the nature of the case, can afford no direct remedy. But the true answer to the objection is, that stockholders have a remedy, a theoretic one indeed and perhaps often inadequate, in the power of the corporation, in its corporate capacity, to obtain redress for injuries done to the common property by the recovery of damages; and each individual stockholder has his remedy through the powers thus vested in the corporation, for the common benefit.

On the whole, the court is of opinion that the demurrer is well taken, and that the action cannot be maintained.

QUESTIONS

1. Do you infer from the decision in the principal case that the plaintiff has no remedy against the directors of his corporation?
2. If a wrong was committed in this case, against whom was it committed? Who should have brought proceedings for redressing the wrong?

3. Upon what theory did the court deny relief to the plaintiff in this case? Would the same conclusion have been reached if the action had been brought by all the stockholders of the corporation?
4. What remedy does a partner have against his copartners if he can show that his copartners are mismanaging the affairs of the firm?
5. D, a director of the X Company, bought ten shares of stock from S, a stockholder in the X Company, at ninety dollars a share, without disclosing to S that valuable mineral deposits had just been discovered on the land of the corporation. When this information became public the market value of the stock went above par. What are the rights of S, if any, against D?

ROTHCHILD *v.* MEMPHIS AND CHARLESTON RAILROAD COMPANY

113 Federal Reports 476 (1902)

WANTY, D. J. The proofs in this case fail to show any actual fraud on the part of the Southern Railway Co. before or at the sale, or any actual control by it of the Memphis & Charleston Railroad. The road was in the hands of receivers appointed by the court from July 14, 1892, until the sale was made on the twenty-sixth of February, 1898. The defendant Southern Railway Co. was not organized until 1894, and there is nothing in the proofs from which any manipulation of the affairs of the Memphis & Charleston Railroad by the Southern Railway Co. since its organization, or by its stockholders before its organization, can be inferred. The relief, in the absence of this proof, must be founded on the allegations in the bill

that the relations of said Southern Railway Company and of your orator and the other stockholders of said Memphis & Charleston Railroad Co. at the time when said sale took place (the said Memphis & Charleston Railroad Co. having abdicated its functions of controlling said property, and it and its board of directors being entirely under the control of the Southern Railway Co.) were the same as those of tenants in common, and the said Southern Railway Co. could not acquire any right, title, or interest in the said property, except for the equal and common benefit of itself and the other stockholders of said Memphis & Charleston Railroad Co., and the Southern Railway Co., a foreign corporation, did not have the right in law to become the purchaser of the Memphis & Charleston Railroad Company's property.

I. Stockholders are not tenants in common of the property of the corporation, and a stockholder, as such, even though he owns a majority of the stock, does not occupy a trust relation toward the

other stockholders, and he may deal with them or with the corporation in good faith. In order to establish a trust relation, the majority stockholder must actually control the affairs of the company for his own benefit and to the prejudice of the minority stockholders. If he is not in control of the property, and does not mismanage it to the prejudice of the minority stockholders, he may purchase, if there is no actual fraud, the property of the corporation at a judicial sale for his own benefit, and he is not accountable to any other stockholder for the property so purchased. In *Mickles* v. *Bank*, 11 Paige, 127, 128, 42 Am. Dec. 103, CHANCELLOR WALWORTH uses this language, which seems apt when applied to the facts here, and has been indorsed by courts and text writers:

> The principal object of the bill appears to be to set aside the sales of the property of the corporation upon the ground that the sales were invalid. In this the complainant must necessarily fail upon the allegations of the bill, even if the corporation is made a party, for the sales were valid, and gave a good title to the purchaser. And one stockholder of a corporation has a perfect right to become a purchaser, for his own benefit, at a sheriff's sale of the corporate property upon an execution against the corporation; nor is he accountable to any other stockholder for such property if there is no fraud in the sale, even where the property is bought in by him much below its value. The remedy of the other stockholders is to attend the sale upon the executions, and bid up the property to its cash value, and thus prevent the same from being sacrificed. The stockholders of a corporation are neither tenants in common of the corporate property nor copartners, either before or after the dissolution of the corporation.

There is nothing in the proof in this case from which it can be found that the Southern Railway Co. ever operated or controlled the property of the Memphis & Charleston Railroad Co., so that no mismanagement of its corporate affairs for the purpose of obtaining advantage at the expense of the minority stockholders can be attributed to it. The sale of the property was not brought about through its manipulation, and it is not shown that the property did not bring a fair price. If the minority stockholders desired to become purchasers, they could have devised a plan of reorganization, and bid in the property if it did not bring what they thought was its full value at the sale. *Oil Co.* v. *Marbury*, 91 U.S. 587, 23 L. Ed. 328. This the complainant did not do, but waited until after the sale had been made and confirmed, and the purchaser had been in possession of and operating the property from February 26, 1898, until August 7, 1899, when he filed this bill, the allegations of which would, if action had

been promptly taken, have brought the defendant Southern Railway Co. within the principles laid down in the cases holding the majority stockholder a trustee in the purchase of the corporate property for the benefit of all of the stockholders of the corporation. But the proofs lack the essential elements of control and mismanagement, without which the relief could not be given, even if the bill had been seasonably filed. The allegations of control, mismanagement, and fraud are emphasized throughout the bill of complaint, but seem to be wholly lacking in the proof, the complainant apparently relying on the position that, when it is shown that a person holding a majority of the stock of a corporation purchases all of its property, there is a presumption of fraud which makes him a trustee for all of the stockholders, and proof of fraud becomes unnecessary. No case in the large number cited by counsel for the complainant justifies this position. In each one there had been actual fraud in the control and mismanagement of the property for the purpose of bringing about its acquisition by the majority stockholder. It is true that every transaction of a majority stockholder with the corporation will be viewed by the courts with jealousy, and set aside on slight grounds; but it is not void, and, if the relations of the majority stockholder are fair and open, there is no rule which forbids his dealing with the corporation, and no presumption that such dealing is fraudulent. The actual control of the property, which is the basis in all of the cases of the trust relation, not existing, and the sale not having been brought about by the fraudulent action of the defendant, it did not, by its purchase, become a trustee for the complainant and other stockholders of the Memphis & Charleston Railroad Co. *Oil Co.* v. *Marbury*, 91 U.S. 587, 23 L. Ed. 328; *McKittrick* v. *Railroad Co.*, 152 U.S. 473, 14 Sup. Ct. 661, 38 L. Ed. 518; *Rogers* v. *Railway Co.*, 33 C.C.A. 517, 91 Fed. 313; *Gillett* v. *Bowen* (C.C.) 23 Fed. 625; *Lucas* v. *Friant*, 111 Mich. 426, 69 N.W. 735; *Bank* v. *Walker*, 66 N.Y. 424; *Spurlock* v. *Railway Co.*, 90 Mo. 200, 2 S.W. 219; *Price* v. *Holcomb*, 89 Iowa, 123, 56 N.W. 735; *Bank* v. *Walker*, 66 N.Y. 424; *Spurlock* v. *Railway Co.*, 90 Mo. 200, 2 S.W. 219; *Price* v. *Holcomb*, 89 Iowa, 123, 56 N.W. 407; Thompson, *Corporations*, sections 1071, 1076, 1079; Cook, *Corporations*, sections 6, 653.

There is nothing in the case of *Farmers' Loan & Trust Co.* v. *New York & N.R. Co.*, 150 N.Y. 410, 44 N.E. 1043, 34 L.R.A. 76, 55 Am. St. Rep. 689, which is relied upon by this complainant, at variance with these views. In that case the New York Central &

Hudson River Railroad Co. purchased a majority of the stock and bonds of the New York & Northern Railway Co., and while its officers were in control of the New York & Northern Railway Co. they declined to accept traffic from other roads that would have produced a fund with which to pay the interest on the bonds; the income of the road which should have been employed to pay the interest was diverted to other and improper purposes, which action occasioned the inability of the company to meet its obligations, the default in which resulted in the foreclosure suit. After making an elaborate review of the authorities, JUDGE MARTIN, for the court, states the rule as follows:

"The principle of the authorities renders it quite obvious that a corporation purchasing a majority of the stock of another competing one cannot obtain control of its affairs, divert the income of its business, refuse business which would enable the defaulting company to pay its interest, and then institute an action in equity to enforce its obligations, for the avowed purpose of obtaining entire control of its property to the injury of the minority stockholders."

The elements of control and mismanagement there existed, and were the basis upon which the judgment rested, and will be found in the cases reviewed by JUDGE MARTIN, and in the cases urged by counsel for complainant here. Their absence in this case is fatal to the appellant's contention.

II. The minority stockholders, as the proof shows, with the full knowledge of all of the proceedings culminating in the sale, made no objection, but permitted the property to be sold to the Southern Railway Co. for a large sum, and that company to expend a large amount of money in its improvement, without making any effort to impeach the sale until the filing of this bill. There is no excuse given for this delay, and the complainant would have thereby lost any right to the relief sought, if he ever had any. *Oil Co.* v. *Marbury*, 91 U.S. 591, 592, 23 L. Ed. 328; *Simmons* v. *Railroad Co.*, 159 U.S. 278, 16 Sup. Ct. 1, 40 L. Ed. 150; *Miles* v. *Vivian*, 25 C.C.A. 208, 79 Fed. 848–53; *Harwood* v. *Railroad Co.*, 17 Wall. 81, 21 L. Ed. 558. In the case of *Oil Co.* v. *Marbury* above cited, JUSTICE MILLER says:

"The doctrine is well settled that the option to avoid such a sale must be exercised within a reasonable time. This has never been held to be any determined number of days or years as applied to every case, like the statute of limitations, but must be decided in each case upon all the elements of it which affect that question."

The decree dismissing the bill was correct, and it is affirmed.

QUESTIONS

1. S, holder of stock in the X Company, sells property to the corporation at a gross over-valuation. The corporation asks that the transaction be declared void as against it. What decision?
2. S enters into a business in competition with the business of his corporation and makes large profits in it. The corporation asks that he be compelled to account for such profits. What decision?
3. S buys a promissory note against his corporation at a discount and brings action on it for its face value. The corporation contends that he can recover from it only the amount paid for the note. What decision?
4. The X Company was the holder of a valuable lease which it expected to renew upon the expiration of the lease. S, without the knowledge or consent of the corporation, secured a lease on the property in his own name and offered it to the corporation at an advanced rental. What are the rights of the corporation, if any, against S?

HUN *v.* CARY

82 New York Reports 65 (1880)

These were cross-appeals. The defendants, Cary, and others appealed from judgment of the General Term of the Supreme Court, in the first judicial department, affirming, as to them, a judgment in favor of plaintiff entered upon a verdict, and affirming an order denying a motion for a new trial. The plaintiff appealed from an order of said General Term reversing its judgment as to defendant Smith, and granting a new trial.

EARL, J. This action was brought by the receiver of the Central Savings Bank of the city of New York, against the defendants, who were trustees of the bank, to recover damages which, it is alleged, they caused the bank by their misconduct as such trustees.

The first question to be considered is the measure of fidelity, care, and diligence which such trustees owe to such a bank and its depositors. The relation existing between the corporation and its trustees is mainly that of principal and agent, and the relation between the trustees and the depositors is similar to that of trustee and *cestui que trust*. The trustees are bound to observe the limits placed upon their powers in the charter, and if they transcend such limits and cause damage, they incur liability. If they act fraudulently or do a wilful wrong, it is not doubted that they may be held for all the damage they cause to the bank or its depositors. But if they act in good faith within the limits of powers conferred, using proper prudence

and diligence, they are not responsible for mere mistakes or errors of judgment. That the trustees of such corporations are bound to use some diligence in the discharge of their duties cannot be disputed. All the authorities hold so. What degree of care and diligence are they bound to exercise? Not the highest degree, not such as a very vigilant or extremely careful person would exercise. If such were required, it would be difficult to find trustees who would incur the responsibility of such trust positions. It would not be proper to answer the question by saying the lowest degree. Few persons would be willing to deposit money in savings banks or to take stock in corporations, with the understanding that the trustees or directors were bound only to exercise slight care, such as inattentive persons would give to their own business, in the management of the large and important interests committed to their hands. When one deposits money in a savings bank, or takes stock in a corporation, thus divesting himself of the immediate control of his property, he expects, and has the right to expect, that the trustees or directors, who are chosen to take his place in the management and control of his property, will exercise ordinary care and prudence in the trusts committed to them—the same degree of care and prudence that men prompted by self-interest generally exercise in their own affairs. When one voluntarily takes the position of trustee or director of a corporation, good faith, exact justice, and public policy unite in requiring of him such a degree of care and prudence, and it is a gross breach of duty—*crassa negligentia*—not to bestow them.

It is impossible to give the measure of culpable negligence for all cases, as the degree of care required depends upon the subjects to which it is to be applied. (*First National Bank* v. *Ocean National Bank*, 60 N.Y. 278.) What would be slight neglect in the care of a quantity of iron might be gross neglect in the care of a jewel. What would be slight neglect in the care exercised in the affairs of turnpike corporation, or even of a manufacturing corporation, might be gross neglect in the care exercised in the management of a savings bank intrusted with the savings of a multitude of poor people, depending for its life upon credit and liable to be wrecked by the breath of suspicion. There is a classification of negligence to be found in the books, not always of practical value and yet sometimes serviceable, into slight negligence, gross negligence and that degree of negligence intermediate the two, attributed to the absence of ordinary care; and the claim on behalf of these trustees is that they can only be held

responsible in this action in consequence of gross negligence, according to this classification. If gross negligence be taken according to its ordinary meaning—as something nearly approaching fraud or bad faith—I cannot yield to this claim; and if there are any authorities upholding the claim, I emphatically dissent from them.

It seems to me that it would be a monstrous proposition to hold that trustees, intrusted with the management of the property, interests, and business of other people, who divest themselves of the management and confide in them, are bound to give only slight care to the duties of their trust, and are liable only in case of gross inattention and negligence; and I have found no authority fully upholding such a proposition. It is true that authorities are found which hold that trustees are liable only for *crassa negligentia*, which literally means gross negligence; but that phrase has been defined to mean the absence of ordinary care and diligence adequate to the particular case. In *Scott* v. *De Peyster* (1 Edw. Ch. 513, 543)—a case much cited—the learned VICE-CHANCELLOR said: "I think the question in all such cases should and must necessarily be, whether they [directors] have omitted that care which men of common prudence take of their own concerns. To require more, would be adopting too rigid a rule and rendering them liable for slight neglect; while to require less, would be relaxing too much the obligation which binds them to vigilance and attention in regard to the interests of those confided to their care, and expose them to liability for gross neglect only—which is little short of fraud itself." In *Spering's Appeal* (71 Penn. St. 11) JUDGE SHARSWOOD said: "They [directors] can only be regarded as mandataries—persons who have gratuitously undertaken to perform certain duties, and who are, therefore, bound to apply ordinary skill and diligence, but no more." In *Hodges* v. *New England Screw Co.* (1 R.I. 312) JENCKES, J., said: "The sole question is whether the directors have or have not bestowed proper diligence. They are liable only for ordinary care; such care as prudent men take in their own affairs." And in the same case, AMES, J., said; "They should not, therefore, be liable for innocent mistakes, unintentional negligence, honest errors of judgment, but only for wilful fraud or neglect, and want of ordinary knowledge and care." The same case came again under consideration in 3 R.I. 9, and GREEN, CH. J., said: "We think a board of directors, acting in good faith and with reasonable care and diligence, who nevertheless fall into a mistake, either as to law or fact, are not liable for the consequences of such mistake."

In the case of *The Liquidators of the Western Bank* v. *Douglas* (11 Session Cases) (3d series) 112 (Scotch), it is said: "Whatever the duties [of directors] are, they must be discharged with fidelity and conscience, and with ordinary and reasonable care. It is not necessary that I should attempt to define where excusable remissness and a gross negligence begin. That must depend to a large extent on the circumstances. It is enough to say that gross negligence in the performance of such a duty, the want of reasonable and ordinary fidelity and care, will impose liability for loss thereby occasioned." In *The Charitable Corporation* v. *Sutton* (2 Atkyns, 405) LORD CHANCELLOR HARDWICKE said, that a person who accepted the office of director of a corporation "is obliged to execute it with fidelity and reasonable diligence," although he acts without compensation. In *Litchfield* v. *White* (3 Sandf. 545) SANDFORD, J., said: "In general, a trustee is bound to manage and employ the trust property for the benefit of the *cestui que trust* with the care and diligence of a provident owner. Consequently he is liable for every loss sustained by reason of his negligence, want of caution, or mistake, as well as positive misconduct."

In *Spering's Appeal*, 71 Penn. St. 11, JUDGE SHARSWOOD said that directors "are not liable for mistakes of judgment, even though they may be so gross as to appear to us absurd and ridiculous, provided they are honest, and provided they are fairly within the scope of the powers and discretion confided to the managing body." As I understand this language, I cannot assent to it as properly defining to any extent the nature of a director's responsibility. Like a mandatary, to whom he has been likened, he is bound not only to exercise proper care and diligence, but ordinary skill and judgment. As he is bound to exercise ordinary skill and judgment, he cannot set up that he did not possess them. When damage is caused by his want of judgment, he cannot excuse himself by alleging his gross ignorance. One who voluntarily takes the position of director, and invites confidence in that relation, undertakes, like a mandatary, with those whom he represents or for whom he acts, that he possesses at least ordinary knowledge and skill, and that he will bring them to bear in the discharge of his duties. (Story on *Bailments*, sec. 182.) Such is the rule applicable to public officers, to professional men and to mechanics, and such is the rule which must be applicable to every person who undertakes to act for another in a situation or employment requiring

skill and knowledge; and it matters not that the service is to be rendered gratuitously. These defendants voluntarily took the position of trustees of the bank. They invited depositors to confide to them their savings, and to intrust the safe keeping and management of them to their skill and prudence. They undertook not only that they discharge their duties with proper care, but that they would exercise the ordinary skill and judgment requisite for the discharge of their delicate trust.

Enough has been said to show what measure of diligence, skill, and prudence the law exacts from managers and directors of corporations; and we are now prepared to examine the facts of this case, for the purpose of seeing if these trustees fell short of this measure in the matters alleged in the complaint. This bank was incorporated by the act, chapter 467 of the Laws of 1867, and it commenced business in the spring of that year, in a hired building, on the east side of Third Avenue, in the city of New York. It remained there for several years, and then moved to the west side of the avenue, between Forty-fifth and Forty-sixth streets, where it occupied hired rooms until near the time of its failure in the fall of 1875. During the whole time the deposits averaged only about $70,000. In 1867, the income of the bank was $942.12, and the expenses, including amount paid for safe, fixtures, charter, current expenses, and interest to depositors, were $5,571.34. In 1868, the income was $5,719.43, and the expenses including interest to depositors, $5,719.43. In 1869, the income was $3,918.27, and the expenses and interest paid $5,346.05. In 1870, the income was $5,784.09 and expenses and interest $7,040.22. In 1871, the income was $13,551.14, which included a bonus of $4,000 or $6,000 obtained upon the purchase of a mortgage of $40,000, which mortgage was again sold in 1874 at a discount of $2,000, and the expenses, including interest paid, were $9,124.05. In 1872 the income was $5,100.51, and the expenses, including interest paid, were $7,212.49. Down to the first day of January, 1873, therefore the total expenses, including interest paid, were $5,046 more than the income. To this sum should be added $2,000 deducted on the sale of the large mortgage in 1874, which was purchased at the large discount in 1871, as above mentioned, and yet entered in the assets at its face. From this apparent deficiency should be deducted the value of the safe and furniture of the bank, from which the receiver subsequently realized $500. At the same date, the amount due to

over one thousand depositors was about $70,000, and the assets of the bank consisted of about $13,000 in cash and the balance mostly of mortgages upon real estate.

While the bank was in this condition, with a lease of the rooms then occupied by it expiring May 1, 1874, the project of purchasing a lot and erecting a banking-house thereon began to be talked of among the trustees. The only reason put on record in the minutes of the meetings held by the trustees for procuring a new banking-house was to better the financial condition of the bank. In February, 1873, at a meeting of the trustees, a committee was appointed "on a site for new building"; and in March the committee entered into contract for the purchase of a plot of land, consisting of four lots on the corner of Forty-eighth Street and Third Avenue, for the sum of $74,500; of which $1,000 was to be paid down, $9,000 on the first day of May, then next, and $64,000 to be secured by a mortgage, payable on or before May 1, 1875, with interest from May 1, 1873, at 7 per cent; and there was an agreement that payment of the principal sum secured by the mortgage might be extended to May 1, 1877, provided a building should, without unavoidable delay, be erected upon the corner lot, worth not less than $25,000. This contract was reported by the committee to the trustees, at a meeting held April 7. On the first day of May, 1873, the real estate was conveyed and the cash payment was made, and four separate mortgages were executed to secure the balance, one upon each lot. The mortgage upon the lot upon which the bank building was afterward erected was for $30,500. At the same time the bank became obligated to build upon that lot a building covering its whole front, twenty-five feet, and sixty feet deep, and not less than five stories high, and have the same inclosed by the first day of November then next. Upon that lot the bank proceeded, in the spring of 1875, to erect a building covering the whole front, and seventy-six feet deep, and five stories high, at an expense of about $27,000. And the building was nearly completed when the receiver of the bank was appointed, in November of that year. The three lots not needed for the building were disposed of, as we may assume, without any loss, leaving the corner lot used for the building to cost the bank $29,250; and we may assume that that was then the fair value of the lot. This case may then be treated as if these trustees have purchased the corner lot at $29,250 and bound themselves to erect thereon a building costing $27,000. When the receiver was appointed, that lot and building and other assets

which produced less than $1,000, constituted the whole property of the bank and subsequently the lot and building were swept away by a mortgage foreclosure, and this action was brought to recover the damages caused to the bank by the alleged improper investment of its funds, as above stated, in the lot upon which the building was erected.

At the time of the purchase of the lot, the bank was substantially insolvent. If it had gone into liquidation, its assets would have fallen several thousand dollars short of discharging its liabilities, and this state of things was known to the trustees. It had been in existence about six years, doing a losing business. The amount of its deposits, which its managers had not been able to increase, shows that the enterprise was an abortion from the beginning, either because it lacked public confidence, or was not needed in the place where it was located. It had changed its location once without any benefit. It had on hand but about $13,000 in cash, of which $10,000 were taken to make the first payments. The balance of its assets was mostly in mortgages not readily convertible. One was a mortgage for $40,000, which had been purchased at a large discount, and we may infer that it was not very salable, as the trustees resolved to sell it as early as May, 1873, and in August, 1873, authorized it to be sold at a discount of not more than $2,500, and yet it was not sold until 1874. In this condition of things the trustees made the purchase complained of under an obligation to place on the lot an expensive banking-house. Whether under the circumstances, the purchase was such as the trustees in the exercise of ordinary prudence, skill, and care, could make; or whether the act of purchase was reckless, rash, extravagant, showing a want of ordinary prudence, skill, and care, were questions for the jury. It is not disputed that, under the charter of this bank, as amended in 1868 (chap. 294), it had the power to purchase a lot for a banking-house "requisite for the transaction of its business." That was a power, like every other possessed by this bank, to be exercised with prudence and care. Situated as this moribund institution was, was it a prudent and reasonable thing to do, to invest nearly half of all trust funds in this expensive lot, with an obligation to take most of the balance to erect thereon an extravagant building? The trustees were urged on by no real necessity. They had hired rooms where they could have remained; or if those rooms were not adequate for their small business, we may assume that others could have been hired. They put forward the claim upon the trial that the rooms they then occupied were not safe. That

may have been a good reason for making them more secure, or for getting other rooms, but not for the extravagance in which they indulged. It is inferable, however, that the principal motive which influenced the trustees to make this change of location was to improve the financial condition of the bank by increasing its deposits. Their project was to buy this corner lot and erect thereon an imposing edifice, to inspire confidence, attract attention, and thus draw deposits. It was intended as a sort of advertisement of the bank, a very expensive one indeed. Savings banks are not organized as business enterprises. They have no stockholders and are not to engage in speculations or money making in a business sense. They are simply to take the deposits, usually small, which are offered, aggregate them, and keep and invest them safely, paying such interest to the depositors as is thus made, after deducting expenses, and paying the principal upon demand. It is not legitimate for the trustees of such a bank to seek deposits at the expense of present depositors. It is their business to take deposits when offered. It was not proper for these trustees —or at least the jury may have found that it was not—to take the money then on deposit and invest it in a banking-house, merely for the purpose of drawing other deposits. In making this investment, the interests of the depositors, whose money was taken, can scarcely be said to have been consulted.

It matters not that trustees purchased this lot for no more than a fair value, and that the loss was occasioned by the subsequent general decline in the value of real estate. They had no right to expose their bank to the hazard of such a decline. If the purchase was an improper one when made, it matters not that the loss came from the unavoidable fall in the value of the real estate purchased. The jury may have found that it was grossly careless for the trustees to lock up the funds in their charge in such an investment, where they could not be reached in any emergency which was likely to arise in the affairs of the crippled bank.

We conclude, therefore, that the evidence justified the finding by the jury that this was not a case of mere error or mistake of judgment on the part of the trustees, but that it was a case of improvidence, of reckless, unreasonable extravagance, in which the trustees failed in that measure of reasonable prudence, care, and skill which the law requires.

This case was moved for trial at a circuit court, and before the jury was impaneled, the defendants claimed that the case was improp-

erly in the circuit, and that it should be tried at special term; and the court ordered that the trial proceed, and at the close of the evidence, the defendants moved that the complaint be dismissed, on the ground that the action was not a proper one to be tried before a jury, and should be tried before the equity branch of the court. The motion was denied, and these rulings are now alleged for error. The receiver in this case represents the bank, and may maintain any action the bank could have maintained. The trustees may be treated as agents of the bank. (*In re German Mining Co.*, 27 Eng. Law & Eq. 158; *Belknap* v. *Davis*, 19 Me. 455; *Bedford Railroad Co.* v. *Bowser*, 48 Penn. St. 29; *Butts* v. *Wood*, 38 Barb. 181; *Austen* v. *Daniels*, 4 Den. 299; *O. & M. Railroad Co.* v. *Mc Pherson*, 35 Mo. 13); and for any misfeasance or nonfeasance, causing damage to the bank, they were responsible to it, upon the same principle that any agent is for like cause responsible to his principal. It has never been doubted that a principal may sue his agent in an action at law for any damages caused by culpable misfeasance or nonfeasance in the business of the agency. The only relief claimed in this complaint was a money judgment, and we think it was properly tried as an action at law. No equitable rights were to be adjusted, and there was no occasion to appeal to an equitable forum.

Treating this, therefore, as an action at law, it follows also that the objection taken that other trustees should have been joined as the defendants cannot prevail. In actions *ex delicto*, the plaintiff may sue one, some, or all of the wrongdoers. (*Liquidators of the Western Bank* v. *Douglas*, 22 Session Cases [2d series, 475] [Scotch]; Barbour of Parties, 203.)

The defendants Hoffman and Gearty filed petitions for their discharge in bankruptcy after the commencement of this action, and were discharged before judgment and they alleged such discharge as a defense to the action. The trial judge at the General Term held that the discharge furnished no defense, and we are of the same opinion. This claim was purely for unliquidated damages occasioned by a tort. Such a claim was not provable in bankruptcy and, therefore, was not discharged. (U.S. Rev. Stat. [2d ed.] secs. 5115, 5119, 5067 to 5071; *Zinn* v. *Ritterman*, 2 Abb. [N.S.] 261; *Kellogg* v. *Schuyler*, 2 Den. 73; *Crouch* v. *Gridley*, 6 Hill, 250; *In re Wiggers*, 2 Biss. 71; *In re Clough*, 2 Ben. 508; *In re Sidle*, 2 Bank, Reg. 77.)

I conclude, therefore, that the judgment appealed from should be affirmed.

The appeal of the plaintiff from the order of the general term, granting a new trial as to defendant Smith, must for reasons stated on the argument, be dismissed, with costs.

QUESTIONS

1. What was the action which brought in the principal case? Who brought the action? What was the wrong alleged to have been committed? To whom will the damages go?
2. What degree of care does the decision in this case exact of directors in the management of a corporation?
3. What is likely to be the result of exacting a too high degree of care of the directors of a corporation? Of exacting a too low degree of care?
4. Do you think that the facts of this case warrant the finding of the jury that the trustees of the corporation were guilty of actionable negligence?

WAINWRIGHT *v.* P. H. AND F. M. ROOTS COMPANY

176 Indiana Reports 682 (1912)

Action by William W. Wainwright against the P. H. & F. M. Roots Co. From a judgment for defendant, plaintiff appeals. Transferred from Appellate Court under section 1405, Burns 1908, Acts 1901, page 590. Reversed.

Cox, J. Appellee is a private manufacturing corporation organized under the laws of this state, and carrying on its business in the city of Connersville. Appellant was formerly the superintendent of its factory, under the supervision of its president; and while acting in this capacity, under a written contract of employment for a term of years which had not yet expired, and as a director of the corporation, he entered into another written contract, which canceled the existing contract, and in which it was agreed, in substance, that appellee would separate from its factory a particular and considerable part of its manufacturing business, and instal it in a special foundry and machine-shop, to be properly constructed and equipped by appellee with the necessary machinery and appliances; that therein certain-named articles were to be manufactured at a fixed schedule of prices; that, in addition to providing the building and machinery, appellee was to furnish all necessary capital to pay for labor and materials for manufacturing the articles to be turned out by the special factory; that appellant was to have entire control over the special factory, and was to provide all labor and materials necessary promptly and efficiently to perform the work contemplated, and was

to turn such work out complete and first class in respect to workmanship, design, and material at the prices fixed in the contract, or lower if possible; that the work was to be done under the cost system, and that if appellant succeeded in producing the work at less than the prices fixed in the schedule, the difference between the prices so fixed and the actual cost was to be divided equally between appellant and appellee; that in addition to such percentage of possible additional profits, appellant was to be compensated by a yearly salary of $1,800, and half the profit on repairs of articles manufactured and returned for repairs; that appellant was not to incur any liability in case of his inability to produce the various articles to be manufactured at the prices named; and that the relation created by the contract should continue for five years.

The contract was entered into and executed by appellant and the president and general manager of appellee company. The performance of its provisions was never entered upon, and appellant sued for damages for its breach, alleging appellee refused to perform its part of the conditions and that he was ready at all times to perform those imposed upon him.

The fourth paragraph of answer alleged that at the time of the execution of the contract sued on, and thereafter, appellant was duly elected, qualified, and acting director of appellee company, and that the contract was therefore illegal and void.

That the contract was illegal and void is the pleaders' conclusion from the bare fact of appellant's relationship to the appellee, as one of its directors, at the time the contract was made, and the question for decision is, therefore, whether as a matter of law it must be so held to be. The cases of *Port* v. *Russell* (1871), 36 Ind. 60, 10 Am. Rep. 5, and *Wayne Pike Co.* v. *Hammons* (1891), 129 Ind. 368, are relied on by counsel for appellee as sustaining the action of the trial court in overruling the demurrer to this answer and the proposition that contracts between directors and their corporations are unqualifiedly void. It is true that language is used in the opinion of the court in the case first mentioned which would seem to indicate that the judge who wrote it firmly believed that the rule should be that all such contracts should be considered void and unenforceable. But this language was used in passing upon the sufficiency of a complaint for equitable relief against contracts between directors and the corporation which the allegations of the complaint showed were procured through a conspiracy among the directors and were saturated

with frauds against the company and for the benefit of the directors in the manner in which they were executed. The allegations of fraud, together with the fiduciary relation of the directors to the corporation, manifestly made a case for equitable relief against the contracts. So far as that case may be said to assert the broad rule to be that all contracts between directors and their corporate body are void, it must be considered dictum without appreciable support anywhere.

Where the opinion in the case of *Wayne Pike Co.* v. *Hammons*, *supra*, touches the question in this case at all we find the following: "The officers of a corporation are its agents, and they are governed by the rules of law applicable to other agents, as between themselves and their principal, in so far as such rules relate to honesty and fair dealing in the management of the affairs of their principal. They can no more use the business of their principal for their own private gain than any other agent, and should they do so they should be held to the same strict rule of accountability as the agent of a private person." The court then applied this statement of the duty of corporate officers to test the sufficiency of a complaint for equitable relief which charged conspiracy and fraud on the part of directors of a corporation in dealing with corporate concerns to their personal advantage.

There are in the books almost innumerable and seemingly conflicting and irreconcilable judicial expressions on this question, many of which are dicta. These judicial pronouncements run from the broad and unqualified propositions that in no case can a director be allowed to take or make a contract with his company and that such contracts when made are void, to the other extreme that such contracts are valid. Between these two boundaries of the case law on the subject is found what is perhaps the more practicable view, that such contracts are merely voidable at the option of the corporation. Mingled with these three general rules there are numerous cases that seemingly involve various departures from a modification of all of them. A general review of what seems to be a condition of fog and confusion in the many cases dealing with the question would be unprofitable and impracticable in this opinion. See, however, 10 Cyc. 794, 807; 21 *American and English Encyclopedia of Law* (2d ed.), 899, *et seq.;* 2 Cook *Corporations* (6th ed.), section 649; 2 Thompson, *Corporations* (2d ed.), section 1224, *et seq.;* 1 Morawetz, *Private Corporations* (2d ed.), section 516, *et seq.;* 2 Purdy's Beach,

Private Corporations, sections 739, 742; 2 Pomeroy, *Eq. Jurisp.* (3d ed.) section 956, *et seq.;* 3 Pomeroy, *Eq. Jurisp.* (3d ed.), section 1077; 1 Page, *Contracts*, section 181.

From the mass of legal discussion of the various phases of the question this appears: That the validity of such a contract, and whether it is even voidable, often depends very much upon its nature and terms, the circumstances under which it was made, and who acted for the corporation in the making. Contracts for the loan of money by a director to his company, and contracts for personal services to it which are outside the scope of his duties as an officer are generally upheld as valid, when such contracts are open and otherwise free from blame. 10 Cyc. 812; 21 *American and English Encyclopedia Law* (2d ed.), 905; 1 Page, *Contracts*, section 181; 2 Thompson, *Corporations* (2d ed.), section 1224, *et seq.; Levering* v. *Bimel* (1897), 146 Ind. 545; *Nappanee Canning Co.* v. *Ried, Murdoch & Co.* (1903), 159 Ind. 614, 59 L.R.A. 199; *Kenner* v. *Whitelock* (1899), 152 Ind. 635; *Twin-Lick Oil Co.* v. *Marbury* (1875), 91 U.S. 587, 23 L. Ed. 328; *Savage* v. *Madelia Farmers' Warehouse Co.* (1906), 98 Minn. 343, 108 N.W. 296; *Henry* v. *Michigan, etc., Assn.* (1907), 147 Mich. 142, 110 N.W. 523; *Garrison Canning Co.* v. *Stanley* (1907), 133 Iowa 57, 110 N.W. 171; *Mitchell* v. *United, etc., Paper Co.* (1907), 72 N.J. Eq. 580, 66 Atl. 938; *Bagley* v. *Carthage, etc., Railway Co.* (1900), 165 N.Y. 179, 58 N.E. 895; *Babcock* v. *Farwell* (1909), 146 Ill. App. 307; note to *Beach* v. *Miller* (1889), 17 Am. St. 291, 298.

The law was correctly stated in *Wayne Pike Co.* v. *Hammons*, *supra*, that directors of corporations are its agents, and in this relationship are governed by the same rules of law and are held to the same strict rule of accountability, honesty, and fair dealing between themselves and their principal in dealing with the subject-matter of their agency as other agents. If the agent act for himself and his principal at the same time in a matter connected with the relation between them, his conduct is constructively fraudulent, and if a contract be the result it is voidable at the election of the principal. It is presumed, where he is thus potentially on both sides of the contract, that self-interest will overcome his fidelity to his principal to his own benefit and his principal's hurt But he may deal directly with his principal, and if they are on equal terms, and the principal has full knowledge of the matter, the contract will be valid, and he may so deal with the principal through other agents who have authority adequately to represent the principal's side of the contract. So

the general rule seems to be that where the contract between a corporation and one of its directors is made on the part of the company by a majority of the directors acting for its interests honestly and in good faith, and with full knowledge of the matter, or by another independent agent with authority to act for it, such contract is not even voidable, except for unfairness or fraud, for the presence of which courts will closely scrutinize the contract. 2 *American and English Encyclopedia of Law and Pr.* 1059, 1068; 1 Morawetz, *Private Corporations* (2d ed.), section 527; 2 Purdy's Beach, *Private Corporations*, section 739; 2 Thompson, *Corporations* (2d ed.), section 1224, *et seq.;* 2 Cook, *Corporations* (6th ed.), section 649; 2 Pomeroy, *Eq. Jurisp.* (3d ed.), section 957; 3 Pomeroy, *Eq. Jurisp.* (3d ed.), section 1077, and notes; Clark, *Corporations* (2d ed.), page 498; note to *Beach* v. *Miller, supra*, pages 300, 307.

In this case we have a complaint involving a contract, so far as appellant is concerned, to render services to his company in the matter of management and superintendence of a part of its general manufacturing business, which was wholly outside his directorial duties. He had been performing similar duties, the allegations of the complaint show, under different terms as to compensation, for years. The contract was prepared by the company and urged upon appellant, and was executed by appellee's president and general manager, an independent agent. It is apparent that the company had full knowledge of the transaction, and if the president and general manager were clothed with authority to make the contract for the corporation, it is not only not void, but not necessarily voidable. The demurrer should have been sustained to the fourth paragraph of answer.

The judgment is reversed, with instructions to the lower court to grant appellant a new trial, to sustain the demurrer to the fourth paragraph of answer, and for further proceedings in harmony with this opinion.

QUESTIONS

1. D, a director of the X Company, owned a patent which he offered to sell to the corporation. The directors considered and accepted the offer. (*a*) D was not present at the meeting of the directors. (*b*) D was present but took no part in the discussion and did not vote for the acceptance of the offer. (*c*) D was present, took part in the discussion, and voted for the acceptance of the offer but his vote was not necessary to bind the corporation to the action. (*e*) D's vote was

necessary to bind the corporation. What are the rights of the corporation, if any, against D under each hypothesis?

2. D, a director of the Y Company, bought a negotiable obligation of the corporation at a discount and sought to enforce it against the corporation for its face value. What decision?
3. The Y Company had a valuable lease which it intended to renew at the expiration of the lease. D, a director of the corporation, took the lease in his own name and offered to assign it to the corporation at an advanced rental. What are the rights of the corporation, if any, with respect to the lease?
4. D, a director of the Z Company, entered into a business in competition with the Z Company from which he made large profits. What are the rights of the corporation, if any, against D?

MITCHELL *v.* REED

61 New York Reports 123 (1874)

Appeal from judgment of the General Term of the Supreme Court in the first judicial department affirming a judgment in favor of defendant, entered upon decision of the court at Special Term.

This action was brought to have certain leases, obtained by the defendant during the existence of a copartnership between him and plaintiff, for terms to commence at its termination, of premises leased and occupied by the firm, declared to have been taken for the partnership, and to have it adjudged that the defendant held them as trustee for the partnership. The facts found were substantially as follows:

The plaintiffs were copartners, conducting and carrying on the Hoffman House in the city of New York. The copartnership, by its terms, expired May 1, 1871; it owned various leases of premises which were used for the partnership business; all of the leases expired at the same time with the copartnership. The firm had spent large sums of money in making valuable improvements and in fitting up the leasehold premises so that they could be beneficially used in connection, and also in fixtures and furnishing, and by their joint efforts had built up a profitable business, and largely enhanced the rental value of the premises. In 1869 the defendant, without any notice of his intent to apply therefor, and without the knowledge of plaintiff, procured renewal leases, in his own name, of the premises for terms commencing at the termination of the partnership leases and of the partnership, which, upon discovery thereof having been made by plaintiff, defendant claimed were his property exclusively, and refused

to recognize or acknowledge that the partnership or plaintiff had any right or interest therein. Other facts appear in the opinion.

The court found, as conclusions of law, that the defendant Reed was the sole owner of the leases executed to him as aforesaid, and that the plaintiff had no right, title, nor interest in or to them, or either of them, and that the defendant have judgment accordingly, to which plaintiff duly excepted. Judgment was rendered accordingly.

The plaintiff commenced this action soon after he ascertained that the defendant had taken the new leases, to-wit: in March, 1870, and the cause was brought to trial in February, 1871.

Earl, C. The relation of partners with each other is one of trust and confidence. Each is the general agent of the firm, and is bound to act in entire good faith to the other. The functions, rights, and duties of partners in a great measure comprehend those both of trustees and agents, and the general rules of law applicable to such characters are applicable to them. Neither partner can, in the business and affairs of the firm, clandestinely stipulate for a private advantage to himself; he can neither sell to nor buy from the firm at a concealed profit to himself. Every advantage which he can obtain in the business of the firm must enure to the benefit of the firm. These principles are elementary, and are not contested. (Story, sec. 174; Collyer, 181, 182.) It has been frequently held that when one partner obtains the renewal of a partnership lease secretly, in his own name, he will be held a trustee for the firm as to the renewed lease. It is conceded that this is the rule where the partnership is for a limited term, and either partner takes a lease commencing within the term; but the contention is that the rule does not apply where the lease thus taken is for a term to commence after the expiration of the partnership by its own limitation, and whether this contention is well founded, is one of the grave questions to be determined upon this appeal.

It is not necessary, in maintaining the right of the plaintiff in this case, to hold that in all cases a lease thus taken shall enure to the benefit of the firm, but whether, upon the facts of this case, these leases ought to enure to the benefit of this firm. I will briefly allude to some of the prominent features of this case. These parties had been partners for some years; they were equal in dignity, although their interests differed. The plaintiff was not a mere subordinate in the firm, but so far as appears, just as important and efficient in its

affairs as the defendant. They procured the exclusive control of the leases of the property, to terminate May 1, 1871, and their partnership was to terminate on the same day. They expended many thousand dollars in fitting up the premises, a portion thereof after the new leases were obtained, and they expended a very large sum in furnishing them. By their joint skill and influence they built up a very large and profitable business, which largely enhanced the rental value of the premises. More than two years before the expiration of their leases and of their partnership, the defendant secretly procured, at an increased rent, in his own name, the new leases which are of great value. Although the plaintiff was in daily intercourse with the defendant, he knew nothing of these leases for about a year after they had been obtained. There is no proof that the lessors would not have leased to the firm as readily as to the defendant alone. The permanent fixtures, by the terms of the leases at their expiration, belonged to the lessors. But the movable fixtures and furniture were worth vastly more to be kept and used in the hotel than to be removed elsewhere. Upon these facts I can entertain no doubt, both upon principle and authority, that these leases should be held to enure to the benefit of the firm. If the defendant can hold these leases, he could have held them if he had secretly obtained them immediately after the partnership commenced, and had concealed the fact from the plaintiff during the whole term. There would thus have been, during the whole term, in making permanent improvements and in furnishing the hotel, a conflict between his duty to the firm, and his self-interest. Large investments and extensive furnishing would add to the value of his lease, and defendant would be under constant temptation to make them. While he might not yield to the temptation, and while proof might show that he had not yielded, the law will not allow a trustee thus situated to be thus tempted, and therefore disables him from making a contract for his own benefit. (*Terwilliger* v. *Brown*, 44 N.Y. 237, and cases cited.) It matters not that the court at Special Term found upon the evidence that the improvements were judicious and prudent for the purposes of the old term. The plaintiff was entitled to the unbiased judgment of the defendant as to such improvements, uninfluenced by his private and separate interest. But, further, the parties owned together a large amount of hotel property in the form of furniture and supplies, considerably exceeding, as I infer, $100,000 in value. Assuming that the partnership was not to be

continued after the first day of May, 1871, this property was to be sold, or in some way disposed of for the benefit of the firm, and each partner owed a duty to the firm to dispose of it to the best advantage. Neither could, without the violation of his duty to the firm, place the property in such a situation that it would be sacrificed, or that he could purchase it for his separate benefit, at a great profit. Much of this property, such as mirrors, carpets, etc., was fitted for use in this hotel, and it is quite manifest that all of it would sell better with a lease of the hotel, than it would if removed therefrom. It is clear that one or both of these parties could obtain advantageous leases of the hotel for a term of years, and hence, if the parties had determined to dissolve their partnership, it would have been a measure of ordinary prudence to have obtained the leases and transferred the property with the leases as the only mode of realizing its value. This was defeated by the act of the defendant, if he is allowed to hold these leases, and thus place himself in a position where the property must be largely sacrificed or purchased by himself at a great advantage. This the law will not tolerate. The language of LORD ELDON, in *Featherstonhaugh* v. *Fenwick* (17 Ves. 311), a case in many respects resembling this, is quite in point. He says: "If they [the defendants] can hold this lease and the partnership stock is not brought to sale, they are by no means on equal terms. The stock cannot be of equal value to the plaintiff, who was to carry it away and seek some place in which to put it, as to the defendants who were to continue it in the place where the trade was already established, and if the stock was sold the same construction would give them an advantage over the bidders. In effect they would have secured the good-will of the trade to themselves in exclusion of their partner." For these reasons, independently of the consideration that the leases themselves had a value to which the firm was entitled upon other grounds and upon authorities to be hereafter cited, the plaintiff, who commenced his suit about one year before the term of the partnership expired, was, upon undisputed principles and authorities applicable to all trustees and persons holding a fiduciary relation to others, entitled to the relief he prayed for.

It has long been settled by adjudications, that generally when one partner obtains the renewal of a partnership lease secretly, in his own name, he will be held a trustee for the firm, in the renewed lease, and when the rule is otherwise applicable, it matters not that the

new lease is upon different terms from the old one, or for a larger rent, or that the lessor would not have leased to the firm. The law recognizes the renewal of a lease as a reasonable expectancy of the tenants in possession, and in many cases protects this expectancy as a thing of value. I will briefly notice a few of the cases upon this subject. In *Holdridge* v. *Gillespie* (2 J. Ch., 30), CHANCELLOR KENT says: "It is a general principle pervading the cases, that if a mortgagee, executor, trustee, tenant for life, etc., who has a limited interest, gets an advantage by being in possession, or 'behind the back' of the party interested in the subject, or by some contrivance or fraud, he shall not retain the same for his own benefit, but hold it in trust." That was a case where a lease was assigned as security, and the assignee surrendered it to the lessor and took a new lease for an extended term of years. In *Phyfe* v. *Wardell*, 5 Paige, 268, CHANCELLOR WALWORTH lays down the general rule, "that if a person who has a particular or special interest in a lease, obtains a renewal thereof from the circumstance of his being in possession as tenant or from having such particular interest, the renewed lease is in equity considered as a mere continuance of the original lease, subject to the additional charges upon the renewal, for the purpose of protecting the equitable rights of all parties who had any interest, either legal or equitable, in the old lease." That case was followed in *Gibbes* v. *Jenkins* (3 Sand. Ch., 131), where it was held that one purchasing a leasehold which was subject to a mortgage and contained no covenant of renewal, could not escape the lien of the mortgage by suffering the lease to expire and afterward obtaining a new lease of the premises; that the new lease in such case, though not a renewal, was a continuance of the original lease for the purpose of protecting the rights of the parties interested in the original lease, both legal and equitable. In these two cases church leases were involved, and some stress was laid upon that fact, as the continuance of such leases was expected as a matter of course, without any covenant of renewal. But the fact that they were church leases could make no real difference in the principle upon which the decisions were based. The fact that a renewal or continuance of a lease is more or less certain, can make no difference with the principle; that springs from the fact that the party obtained the new lease from the position he occupied, being in possession and having the good will which accompanies that, or being connected with the old lease in some way, and thus enabled to

take an inequitable advantage of other parties also interested, to whom he owed some duty.

In *Struthers* v. *Pearce* (51 N.Y. 357), it was held that when, during the existence of a continuing copartnership of undetermined duration, three of four copartners, without the knowledge of the other, obtained a new lease in their own names, of premises leased and used by the firm, the same became partnership property, and upon dissolution the other partner was entitled to his proportion of the value. In that case the defendants intended to dissolve the copartnership as early as August, and gave written notice on the eighteenth day of September, 1865, for the dissolution on the thirty-first day of December, following. On the eleventh day of September, the defendants secretly obtained a new lease, in their own names, of the same premises, for a term of five years, to commence May 1, 1866. I think that case is fairly decisive of this. It is true that a period for a dissolution of the partnership had not been fixed when the new lease was taken, but negotiations were pending for its dissolution, and a few days after the new lease was taken, a time for its dissolution was fixed by a written notice. But it can make no difference that the partnership might have been continued by the parties until after the new term commenced. So it might here, if the parties had so willed. There they had the right to dissolve it at any time. The principle which lies at the foundation of the decision of that and all similar cases must be the one above stated, that the defendants in possession took advantage of their position to procure the new lease, and thus deprived the plaintiff of a benefit to which he, with them, was equally entitled. In a note to *Moody* v. *Matthews* (17 Ves., 185, Sumner's ed.) the learned editor says, as a deduction from adjudged cases, that "with a possible exception in favor of a bona fide purchaser, it seems to be a universal rule that no one who is in possession of a lease or a particular interest in a lease which lease is affected with any sort of equity in behalf of third persons, can renew the same for his own use only; but such renewal must be construed as a graft upon the old stock." In *Clements* v. *Hall* (2 De G. & J., 173), where one partner in a mining partnership died in 1847, and the surviving partner thereafter worked the mine without a new lease thereof, claiming to do so for his own benefit, until 1850, when the lessor gave him notice to quit in March, 1851, when he entered into new negotiations with the lessor for a new lease, and obtained one of the greater part of the

mine, on terms much more burdensome than those of the old tenancy, it was held that those who claimed under the will of the deceased partner were entitled to a share of the benefit in the new lease. In *Clegg* v. *Fishwick* (1 McN. & G. 294) one of several partners working a mine under a lease died, and the firm business was thereafter carried on for several years between the surviving partners and the plaintiff, widow of the deceased partner. Finally, the old lease expired, and some of the partners took a new lease of the mine without the privity of the plaintiff. It was held that the estate of the deceased partner was interested in the new lease. The LORD CHANCELLOR says: "The old lease was the foundation of the new lease, the tenant's right of renewal arising out of the old lease giving the partners the benefit of this new lease; at least the law assumes it to be so. Without saying at all what circumstances there may be to interfere with that ordinary right, we know that the rule of equity is that parties interested jointly with others in a lease, cannot take to themselves the benefit of a renewal to the exclusion of the other parties interested with them." In *Clegg* v. *Edmondson* (8 De G., McN. & G. 787) the managing partners of a mining partnership at will gave notice of dissolution to the rest, and intimated their intention, after the dissolution, to apply for a new lease for their own exclusive benefit, and did so and obtained a lease, and it was held to enure to the benefit of the partnership. See, also, the leading cases of *Featherstonhaugh* v. *Fenwick* (17 Ves. 298) and *Keeck* v. *Sanford* (2 Eq. Cas. Abdg , 741), and notes to the latter case in 1 *Leading Cases in Equity*, 32, where the whole doctrine is discussed and conclusion reached in harmony with the views above expressed. I therefore conclude that it makes no difference that these leases were obtained for a term to commence after the partnership, by its own limitation, was to terminate. I can find no authority holding that it does, and there is no principle sustaining the distinction claimed. The defendant was in possession as a member of the firm, and the firm owned the good will for a renewal, which ordinarily attaches to the possession. By his occupancy, and the payment of the rent, he was brought into intimate relations with the lessors; he became well acquainted with the value of the premises and he took advantage of his position, during the partnership, secretly to obtain the new leases. He must hold them for the firm.

I am therefore of the opinion that the judgment should be reversed, and new trial granted, costs to abide the event.

QUESTIONS

1. What is meant when it is said that the relation between partners is one of trust and confidence?
2. A and B, partners, are negotiating with X for the purchase of a piece of reality. X gives A five hundred dollars as a commission for inducing B to agree to the purchase. What are the rights of the firm, if any, against A?
3. A and B are partners engaged in buying and selling real estate for profit. A buys a piece of land on his own account and resells it at a profit of $1,500 without the knowledge of A. What are the rights of the firm, if any, against A?
4. A, B, and C enter into a partnership for the purpose of carrying on a retail dry goods store. In the articles of partnership it is agreed that each partner shall devote his undivided time and attention to the affairs of the partnership. A, however, becomes a partner with X and Y in the real estate business to which he devotes several hours in the evening after the dry goods store is closed. What are the rights of the firm, if any, against A?
5. It is expressly agreed between the partners that credit will not be extended to anyone without the consent of all. B in violation of this agreement extends credit to D. The firm is unable to collect from D. What are the rights of the firm, if any, against B?
6. P recovers a judgment of $5,000 against the firm and secures satisfaction of the judgment against the individual estate of C. What are the rights of C under the circumstances?
7. It is said that each partner is entitled to a complete accounting from his copartners. What is meant by this statement?

CHAPTER VI

RESPONSIBILITY FOR TORTS AND CRIMES

NIMS *v.* MOUNT HERMON BOYS' SCHOOL

160 Massachusetts Reports 177 (1893)

KNOWLTON, J. The defendant is an educational corporation. The plaintiff seeks to recover damages for an injury received through the negligence of a ferryman in managing a boat on which he was a passenger, and which, as he alleges, the defendant was using at a public ferry in the business of carrying passengers for hire. At the request of the defendant, the presiding justice ruled that there was no evidence to warrant a finding for the plaintiff, and directed a verdict for the defendant. The defendant contends that the ruling should be sustained on one or both of two grounds. It says in the first place, that, if it maintained the ferry and hired and paid the ferryman, the business was *ultra vires* and therefore it is not liable for negligence in the management of the boat. Secondly, it contends that there was no evidence to connect the corporation with the business of running the ferry-boat, or to show that the ferryman was its servant.

It is a general rule that corporations are liable for their torts as natural persons are. It is no defense to an action for a tort to show that the corporation is not authorized by its charter to do wrong. Recovery may be had against corporations for assault and battery, for libel and for malicious prosecution, as well as for torts resulting from negligent management of the corporate business. *Moore* v. *Fitchburg Railroad*, 4 Gray, 465; *Reed* v. *Home Savings Bank*, 130 Mass. 443; *Merchant's Bank* v. *State Bank*, 10 Wall. 604; *National Bank* v. *Graham*, 100 U.S. 699.

If a corporation by its officers or agents unlawfully injures a person whether intentionally or negligently, it would be most unjust to allow it to escape responsibility on the ground that its act is *ultra vires*. The only plausible ground on which the defendant in the present case can contend that it should be exempt from liability for the negligence of its servant in managing the ferry-boat is that the contract to carry the plaintiff was *ultra vires*, and therefore invalid,

and that the duty for neglect of which the plaintiff sues arose out of the contract, and disappears with it when the contract appears to be void. The defendant may argue that the plaintiff cannot maintain an action for a breach of the contract to use proper care to carry him safely and that he stands no better when he sues in tort for failure to do the duty which grew out of the contract.

In *Bissell* v. *Michigan Southern & Northern Indiana Railroad*, 22 N.Y. 258, the plaintiff founded his action on the negligence of the two defendants while jointly running cars on a railroad in a state to which the charter of neither of them extended, and it was conceded that the defendants were acting *ultra vires*. The plaintiff recovered, COMSTOCK, C. J., holding, in an elaborate opinion that the corporations were liable under their contract, notwithstanding that the contract was *ultra vires*, and that if they could not be held under their contract they could not be held at all, inasmuch as the only negligence alleged was a failure to use the care which the contract called for. SELDEN, J., in an equally full and elaborate opinion, held that the contract for carriage was invalid, and that there could be no recovery under it, nor for negligence founded upon it; but it was his opinion that, if the contract was invalid, and that there could be no recovery under it, nor for negligence founded upon it; but it was his opinion that, if the control were set aside, the defendants owed the plaintiff a duty founded on his relation to them as an occupant, with their permission, of a place in their car, and that the improper management of the car was a neglect of that duty for which the plaintiff could recover. CLARKE, J., agreed with the view, and all but one of the other judges concurred in a decision for the plaintiff, without stating the ground on which they thought the decision should be placed. This case was followed in *Buffett* v. *Troy & Boston Railroad*, 40 N.Y. 168, in which it was held that a railroad corporation was liable for negligence of the driver of a stage-coach which it was running without a legal right to do a business of that kind; but the opinion does not show whether the decision is founded on the opinion of COMSTOCK, C. J., given in the former case, or on that of SELDEN, J. Like decisions have been made under similar facts in *Central Railroad & Banking Co.* v. *Smith*, 76 Ala. 572; *New York, Lake Erie & Western Railway* v. *Haring*, 18 Vroom, 137.

The better doctrine seems to be that a contract made by a corporation in violation of its charter, or in excess of the powers granted to it either expressly or implication, is invalid, considered merely as a

contract, and, so long as it is entirely executory, will not be enforced. It is not only a violation of a private trust, viewed in reference to the stockholders, but it is against the policy of the law, which intends that corporations deriving their powers solely from the legislature shall not pass beyond the limits of the field of activity in which they are permitted by their charter to work. *Monument National Bank* v. *Globe Works*, 101 Mass. 57; *Attorney-General* v. *Ice Co.*, 104 Mass. 239; *Davis* v. *Old Colony Railroad*, 131 Mass. 258; *Leslie* v. *Lorillard*, 110 N.Y. 519; *East Anglion Railways* v. *Eastern Counties Railways*, 11 C.B. 775. On the other hand, courts have frequently held that, while such contracts considered merely as contracts are invalid, they involve no such element of moral or legal wrong as to forbid their enforcement if there has been such action under them as to work injustice if they are set aside. Courts have been astute to discover something in the nature of an equitable estoppel against one who, after entering into such a contract, and inducing a change of condition by another party, attempts to avoid the contract by a plea of *ultra vires*. It is said that such a plea will not avail when to allow it would work injustice and accomplish legal wrong. *Leslie* v. *Lorillard*, 110 N.Y. 519; *Lindauf* v. *Lombard*, 137 N.Y. 417. Many cases might be supposed in which it would be most unjust to hold that one who has received the benefits of such a contract might retain them and leave the other party without remedy, as he might do in a supposable case, where another had put himself at a disadvantage on the faith of a contract with him to commit a crime. Whether in this Commonwealth a contract entered into by a corporation *ultra vires*, and partly performed, will ever be enforced on equitable grounds, we need not now decide. See *McCluer* v. *Manchester & Lawrence Railroad*, 13 Gray, 124; *National Pemberton Bank* v. *Porter*, 125 Mass. 333; *Atlas National Bank* v. *Savery*, 127 Mass. 75; *National Bank* v. *Matthews*, 98 U.S. 621; *Oil Creek & Allegheny River Railroad* v. *Pennsylvania Transportation Co.*, 83 Penn. St. 160. In the present case we think it makes no difference that the defendant was not a manufacturing or trading corporation, but was chartered for educational purposes only. It could acquire and hold property, make contracts, and do anything else incidental to the maintenance of the school. Doubtless some of its officers or agents thought it would be an advantage to its students and managers to have a public ferry at the place where the plaintiff was injured. Its maintenance of such a ferry was *ultra vires*, but its acts in that respect were not different in kind

from the ordinary acts of corporations in excess of the powers given them by their charters. We are of opinion, therefore, that if the defendant while running the ferry-boat accepted the plaintiff as a passenger to be transported for hire, and undertook to carry him across the river, he was in the boat as a licensee, it owed him the duty to use proper care to carry him safely, and whether an action could be maintained for a breach of the contract or not, it is liable to the plaintiff in an action of tort for neglect of that duty.

QUESTIONS

1. The D Company, a corporation engaged in the newspaper business, published an actionable libel concerning P. P sues the company for damages. What decision?
2. X, an employee of the D Company, while collecting bills, unnecessarily assaults P. P sues the corporation for damages. What decision?
3. X, an employee of the D Company, while operating a switch engine, negligently injures P. P sues the company for damages. What decision?
4. What was the decision of the court in the case of *Bissell* v. *Michigan Southern & Northern Indiana Railroad*, 22 N.Y. 253, cited in the opinion of the principal case?

STATE *v.* LEHIGH VALLEY RAILROAD COMPANY

90 New Jersey Law Reports 372 (1917)

SWAYZE, J. It has long been settled in this state that a corporation aggregate may in a proper case be held criminally for acts of malfeasance as well as for nonfeasance. *State* v. *Morris & Essex Railroad Co.*, 23 N.J.L. 360; *State* v. *Passaic County Agricultural Society*, 54 *Id.* 260. So well settled is the general rule that in the later cases it has not been even questioned. *State* v. *Erie Railroad Co.*, 83 *Id.* 231; 84 *Id.* 661; *State* v. *Lehigh Valley Railroad Co.*, 89 *Id.* 48; *ante*, page 340. Notwithstanding these decisions it is now argued that a corporation aggregate cannot be held criminally for manslaughter.

We need not consider whether the modification of the common law by our decisions is to be justified by logical argument; it is confessedly a departure at least from the broad language in which the earlier definitions were stated, and a departure made necessary by changed conditions if the criminal law was not to be set at naught in many cases by contriving that the criminal act should be in law

the act of a corporation. The modern rule, as well as the reasons for it, was so well stated by CHIEF JUSTICE GREEN, in the earliest case above cited, that his opinion may fairly be said to be the classical judicial deliverance on the subject. The CHIEF JUSTICE recognized that there were certain crimes, for example, perjury, of which a corporation cannot in the nature of things be guilty; and there were other crimes, for example, treason and murder, for which the only punishment imposed by law cannot be inflicted upon a corporation; he added, however, without any specific illustration that a corporation could not be liable for any crime of which a corrupt intent or *malus animus* is an essential ingredient. We need not consider what crimes may be included under the last exception. It is enough to say that the case is an authority which we are not at liberty to question, and would not question if we might, for the proposition that a corporation aggregate may be held criminally for criminal acts of misfeasance or nonfeasance unless there is something in the nature of the crime, the character of the punishment prescribed therefor, or the essential ingredients of the crime, which makes it impossible for a corporation to be held. Involuntary manslaughter does not come within any of these exceptions. It may be the result of negligence merely and arise out of mere nonfeasance. That a corporation may be guilty of negligence is now elementary; that it could be held criminally for nonfeasance was settled by numerous precedents cited by the CHIEF JUSTICE (at pp. 364, 365). We think of no reason why it should not be held for the criminal consequences of its negligence or its nonfeasance. There is nothing in the punishment prescribed which makes it impossible to punish a corporation. Section 109 of the Crimes Act prescribes in the alternative a fine of $1,000 or imprisonment not exceeding ten years, or both. Clearly, a corporation may be punished by way of fine. The punishment is prescribed only for persons, but by section 9 of the act relative to statutes the word "person" is declared to include bodies corporate (artificial persons) as well as individuals (natural persons) and the same provision in a somewhat different form appears in section 220 of the Crimes Act.

It is argued that the essential ingredients of manslaughter make it impossible to hold a corporation therefor. The crime was a felony at common law and some of the old authorities define homicide as the killing of one human being by another human being; that manslaughter was a felony at common law is not to the point, since "the distinction between felonies and misdemeanors is not observed in our criminal

code." *Jackson* v. *State* 49 N.J.L. 252; *Brown* v. *State*, 62 *Id.* 666 (at p. 695).

Although it may be necessary in applying some of the old legal rules to our jurisprudence, to regard certain crimes called by our statute misdemeanors, as the equivalent of felonies for the application of common-law rules, that necessity is one of terminology only; otherwise, there is now in this state no essential distinction between the two grades of offense known to the common law. We are unable to attribute to the ancient classification of manslaughter as a felony, the force in our modern jurisprudence which counsel claims for it.

As to the definition of homicide cited by counsel, it is enough to say that authorities of equal eminence define it differently. Blackstone, for example, in the passage cited in the brief (4 Bl. Com. 188), defines felonious homicide as, "the killing of a human creature, of any age or sex, without justification or excuse." He then adds by way of illustration: "This may be done either by killing one's self, or another man." Blackstone does not say that these are the only cases of felonious homicide; as far as his text goes, the case of involuntary manslaughter by a corporation aggregate is not excluded, and is within the words of his definition. But if we assume, as is probably the fact, that Blackstone did not have in mind the case of involuntary manslaughter by a corporation aggregate as a possible case of felonious homicide, nevertheless, his illustration of suicide as a felonious homicide shows that the definition relied upon (killing of one human being by another human being) is inaccurate. We need not italicize the word "another" to show the conflict.

We do not forget that voluntary manslaughter involves ingredients quite different from those involved in involuntary manslaughter. The indictment is in statutory form. Under the statute there is no difference between an indictment for voluntary, and an indictment for involuntary, manslaughter, and a defendant may be convicted of either. *State* v. *Thomas*, 65 N.J.L. 598. If his constitutional right to be informed of the nature and cause of the accusation were not sufficiently protected by the form of indictment prescribed by the statute, the obligation is not available to the present defendant, who has been furnished with a bill of particulars showing that the charge relied upon is that of involuntary manslaughter.

We have examined the authorities in other jurisdictions to which we were referred. The decision of *People* v. *Rochester Railway & Light Co.*, 195 N.Y. 102; 88 N.E. Rep. 22; reported with note, 16

Ann. Cas. 837, was based entirely upon the construction of the exact language of the penal code, which defined homicide as "the killing of one human being by the act, procurement or omission of another," and the court necessarily, we think, held that "another" meant "another human being." But JUDGE HISCOCK, now the eminent CHIEF JUDGE, who spoke for the court, was at some pains to show that there was nothing essentially incongruous in holding a corporation aggregate criminally liable for manslaughter. The case is a good illustration of the way in which the proper growth and development of the law can be prevented by the hard and fast language of a statute, and of the advantage of our own system by which the way is open for a court to do justice by the proper application of legal principles.

The case of *Commonwealth* v. *Illinois Central Railroad Co.*, 152 Ky. 320; 153 S.W Rep. 459, rests on the inaccurate definition of homicide to which we have already referred.

The case of *Regina* v. *Great Western Laundry Co.*, 13 Man. 66, rests chiefly on the absence of precedent. We cannot avoid the feeling that the learned judge attributed too much importance to this lack. We think the true question is whether the indictment is in harmony with established legal principles, as we think it is; we are not troubled by the fact that the case is one of first impression in New Jersey.

It is urged that the indictment should at least be quashed as to all the defendants except the Lehigh Valley Railroad Co., since the bill of particulars is directed at that defendant only. An indictment otherwise valid cannot be vitiated by the bill of particulars, although some motion depending on the latter may properly be raised at the trial. Moreover, a motion to quash is addressed to our discretion. *State* v. *Pisanello*, 88 N.J.L. 262. That discretion ought not to be exercised in a case like this where injustice may be done thereby to the state and where the refusal to exercise it deprives the defendants of no substantial rights, since the question can be raised at the trial.

The motion to quash is denied. Let the record be remitted to the Hudson Quarter Sessions for trial.

QUESTIONS

1. A statute makes it a punishable offense for "any person to sell cigarettes to minors." The D Company, being indicted for a violation of this statute, demurs to the indictment. What decision?

2. X, an employee of the corporation, while acting for the corporation, assaults P. The corporation is indicted for a criminal assault. It demurs to the indictment. What decision?
3. The corporation is indicted for criminal libel. It demurs to the indictment. What decision?
4. The corporation is indicted for perjury. It demurs to the indictment. What decision?
5. The corporation is indicted for manslaughter. The only punishment provided for manslaughter in the state in question is imprisonment. The corporation demurs to the indictment. What decision?
6. A, B, and C are partners. A, while purporting to act for the firm, commits a crime. A, B, and C are separately indicted for the crime. Each demurs to the indictment. What decision?

GUARANTEE TRUST AND SAFE DEPOSIT COMPANY *v.* E. C. DREW INVESTMENT COMPANY

107 Louisiana Reports 251 (1901)

PROVOSTY, J. The defendant firm, the E. C. Drew Investment Co., was engaged in the business of buying and selling lands and timber and of acting as agent for the owners of lands and timber in selling the same. It bargained with the codefendant, Manning S. Maguire, for the sale to him of timber, and referred him to its agent Lee Harris, one of the defendants, to point out the timber and agree upon a price. Harris pointed out the timber of plaintiff, and Maguire cut, removed, and sold the same. And this suit is for damages against all said parties and against the members of the E. C. Drew Co. individually, *in solido*, upon allegations of conspiracy to depredate upon plaintiff's lands.

Maguire pleads the general denial, and that he bought the timber in good faith. The E. C. Drew Investment Co. and the members individually plead the general denial, and also that the timber sold by them was on their own property. They specially deny the allegations of conspiracy.

We think that Maguire bought the timber in good faith. Drew & Co. were a reputable firm selling timber for their own account and for others; to deal with them was in regular course. Maguire was under no obligation to investigate their authority; our law does not expect that suspicion and distrust shall inspire the conduct of our business men in dealing with each other, but rather an honest

business confidence. Good faith, says our code, is presumed until disproved.

For certain purposes registry conveys notice, or knowledge, and defendant's counsel argues that the registry of plaintiff's title conveyed to Maguire knowledge that Drew & Co. were not owners of the land. Counsel cites in support of this contention the case of *Heirs of Dohan* v. *Murdock*, 41 Ann. 494. The case is good authority against the contention of counsel. See also the cases of 4 La. 474; 5 La. 242; 33 Ann. 769; 38 Ann. 885; and *Heirs of Ford* v. *Phillips*, 47 Ann. 339.

The E. C. Drew Investment Co. and the individual members thereof must be held liable to plaintiff as trespassers in bad faith. The sale of the timber was made advisedly; and it was made in the course of the partnership business, by the managing partner of the firm, in the name of and for the benefit of the firm; and the price went into the coffers of the firm. Under these facts all the partners are liable.

The defenses are, first, that Drew did not authorize Harris to sell the timber on the land of plaintiff, but only the timber on the land of the E. C. Drew Investment Co.; and, second, on the part of the individual members of the firm, that they had no knowledge of the transaction, and, as a consequence, are not parties to it and are not responsible for it.

If it were conceded that Harris in selling the timber of plaintiff transcended his authority, still, on familiar principles, the partnership would be liable since the act was done in the course of the execution of the agency.

But, as a matter of fact, Harris did not transcend his authority. When he made the sale he had in his possession a map on which were marked the lands of the Drew Co., and among these the lands of the plaintiff figured; and he testifies that this map was given him by Drew for his guidance in making the sale. If so, he did not transgress his authority. Drew was not permitted to testify on the trial, as to whether he had, or not, given such a map to Harris, the court holding that the point was settled by a judgment on a rule taken on Drew early in the case to produce the map; which, it seems, had been left by Harris in the office of the Drew Co. Whether this ruling was correct or not, need not be considered, for if we assumed that Drew had testified and had denied most positively and circumstantially that he had given the map, we should accept the statement of Harris on the subject; and this for two reasons: First, that it accords with

the attending circumstances of the case; and, secondly, that on the trial of the rule in question Drew testified that he did not "exactly remember" whether he had given any map at all to Harris; and, of course, this absence of recollection could not well be reconciled with a subsequent positive denial.

The want of knowledge on the part of a member of a firm of the tort of his copartner will not be good ground for exemption from liability for such tort, if, as in this case, the tort was committed in the course of the partnership business, and in the name of and for the benefit of the partnership; and especially if the partnership profited by the transaction.

In combatting this proposition, counsel for defendant cite Addison on *Torts*, Volume 1, page 667, as follows:

"One partner cannot drag another into a trespass without his previous consent, or without his subsequent concurrence. It must be shown, either by evidence before the transaction that they joined in committing the trespass, or by evidence afterwards that they concurred in and received the benefit of it."

If by this is meant merely what is said, namely, that as a general proposition one partner cannot drag his copartners without their consent into every trespass which he may choose to indulge in, we have nothing to say; but if it is meant to contradict the proposition laid down above, then we must call upon the author to cite his authorities. Two cases are referred to by him in his marginal notes in support of the text. One of these cases, *Petrie* v. *Lamont*, we have not had access to; the other, *Chester* v. *Dickerson, et al.*, 54 N.Y. 1, was cited either by mistake, or as a case, contra; for it certainly does not support the text. One of the members of a partnership between dealers in real estate poured petroleum upon a tract of land to induce plaintiff to believe that it was oil-producing land, and sold the land to plaintiff as of that character, all without the knowledge of his copartners: held, syllabus, as follows:

"Where a fraud is perpetrated by one of the members of such partnership in the prosecution of a partnership enterprise, all the partners are liable, although the others had no connection with, knowledge of, or participation in the fraud."

Thus it is seen that the case does not support the text. But counsel cite one of our decisions, *Allen, Nugent & Co.* v. *Carey, et al.*, 33 Ann. 1455, as supporting the text in question. On examination it will be found that that case is authority for nothing more than that

a partner cannot bind the firm as security for the debt of himself or of a third person, outside of the course of the partnership business.

The proposition laid down by us above is well supported by authority.

In the *American and English Encyclopedia of Law*, Volume 17, page 1067, we find the following:

"While the willful and malicious torts of a member of a firm are not usually within the scope of his employment, and consequently do not render his partners liable, yet if such an act is committed clearly and plainly for the benefit of all, and in the usual and ordinary prosecution of the partnership business, all are liable, notwithstanding the malicious motives of the partner committing the act."

Story, treating the same subject, after discussing the liability as deduced from the maxim, *qui facit per alium facit per se*, goes on, as follows:

"The doctrine has been carried further; and the partnership has been held for libel which was published and sold by one partner in the course of the business of the firm, as, for example, by a printer or bookseller, one of the firm in that business. The same rule might apply to cases of written slander, as by declaring a rival merchant a bankrupt, or a cheat, if written in the name, and as an act, of the firm. So, if breaches of the revenue laws by fraudulent importations, or smuggling, or entries at the customhouse, are committed by one of the firm in the course of the business thereof, all of the firm would be liable penally, as well as civilly, therefor." Story on *Partnership*, para. 166.

In a note on page 149 of Lindley on *Partnership*, Wentworth's notes, we find the law on the subject stated, as follows:

"Partners are liable in civil actions upon the principle of agency for the fraudulent or malicious conduct of one of their members done without the knowledge of the others for the benefit of the partnership and within the scope of its business." Citing a long list of cases.

In the case of *Stockwell* v. *United States*, 13 Wallace, 491, the defendants were sued as members of a partnership for double the value of certain shingles imported by the partnership without payment of import duties. The debt was by way of penalty for breach of the revenue laws. The fraud upon the government was the act of only one of the members of the firm, the other members had no knowledge of it; but the firm received the shingles, and sold them in due course of business. It was argued that the innocent members of the

firm could not be charged with knowledge of the fraud of their associate. The court held that they were liable, and in the course of the opinion said:

"It is not seriously denied that in civil transactions a principal or a partnership is affected by a knowledge of the agent or copartner, and that the knowledge of the agent is in law attributed to his principal, as well as that of the partner to all the members of the firm; nor is it much insisted that a principal, or a copartner, is not liable for the tort of an agent, or copartner, done without his knowledge or authority, in suits brought by third persons to recover compensation or indemnity for loss sustained in consequence of the tort; but it is argued that the rule does not apply to the case of suits for a penalty." And again:

"That as a general rule partners are liable to make indemnity for the tort of one of their number, committed by him in the course of the partnership business, is familiar doctrine. . . . . The tortious act of the agent is the act of the principal, if done in the course of his agency, though not directly authorized. And this is emphatically true when the principals, as in this case, have received and appropriated the benefit of the act."

The same rule obtains in the civil law. We translate from Fuzier Herman, 1384, as follows:

"The responsibility of the principal for the injury caused by his agent is not restricted to cases where the acts complained of came within the terms of the agent's authority; in order that the principal should be responsible it is sufficient that the act complained of should be connected with '(*se rattache à*)' the object of the agency, and that it should have been done in the course of the execution of the agency, (*à l'occasion de son exécution*)."

Among the cases cited as illustrative of the acts for which the principal is thus held to be responsible, we find the following: Owner of a line of stage-coaches held liable for damage caused by one of its drivers in diverting travelers from plaintiff's hotel. Bordeaux, 29 Juillet, 1856. Railway company liable to government for smuggling done by one of the employees on its trains. Lyon, 1er. Juillet, 1872. All members of firm civilly liable for a forgery committed by one of the members in the course of the partnership business. Alger, 29 Mai, 1879. Lessees of a preserve civilly liable for murder of one of the sublessees by one of the special guards in the course of a hunting expedition in which the murderer was taking part in his capacity

of guard. Paris, 19 Mai, 1874. These are, of course, the extreme cases, and are given here, not by way of approval, but merely to show how far the doctrine has been carried.

The liability of the innocent partners is not to be deduced entirely and exclusively from the principles of the law of agency. As stated by JUDGE STORY, *supra*, it "has been carried." It derives also to some extent from the equity of making the loss fall, as between two innocent parties, on the one of the two who contributed to bring it about. By holding themselves out as members of the firm of Drew & Co., the defendants gave business standing to the concern, thereby contributing to the tort. If it had not been for the prestige given by them to the firm, Maguire might not have dealt with Drew, or, at least, might have been more cautious. In fact, Drew, standing by himself, might have been entitled to so little confidence that in dealing with him Maguire might have exposed himself to the imputation of bad faith. We do not wish to be understood as saying that such was the case, but only that such might have been the case. The record does not show what the reputation or business standing of Mr. Drew were. For all we know they may have been very good. The fact that Maguire can find shelter behind the reputableness and responsibility which these innocent members have contributed to impart to the firm, shows that these members are to some extent responsible for the tort. The liability of the innocent members is also founded in part on motives of public policy. It would be dangerous to the community to allow a set of men to depredate upon the public under the shelter of an irresponsible associate; as might be done with impunity, if so-called innocent members of a firm might hold themselves out as members, and yet not be liable for the acts of their partner in matters within the scope of the partnership business.

The E. C. Drew Investment Co. and its members are, therefore, liable for the timber sold at Monroe, namely, $4.50 per thousand feet.

The defendants being held for a tort, their liability is *in solido*. Art. 2324 C.C.

It is, therefore, ordered, adjudged, and decreed that the judgment of the lower court be set aside; and it is now ordered adjudged and decreed that the plaintiff, the Guarantee Trustee and Safe Deposit Co., have judgment against all of the defendants, namely, E. C. Drew Investment Co., Robert B. Blanks, John B. Parker, J. E. Reynolds, E. C. Drew, Lee Harris and Manning Maguire, *in solido*,

for the sum of $330.50 with legal interest from this date; and against all of said parties, except Manning S. Maguire, *in solido*, for the additional sum of $2,643, with legal interest thereon from this date; reserving to Manning S. Maguire his right to sue the proper parties for the sum herein decreed to be paid by him. The defendants to pay the cost in both courts.

QUESTIONS

1. A, B, and C are partners engaged in buying and selling realty. A, while attempting to sell land to P, fraudently misrepresented the area of the land. P sues A, B, and C jointly. What decision?
2. A, B, and C are engaged in the retail furniture business. B, for advertising purposes, against the wishes of his copartners, put a piece of furniture in the window of the store, on which he displayed this sign: "This furniture has just been taken back from P. It is a warning to deadbeats." The first statement was false. P sues A, B, and C in defamation. What decision?
3. A borrowed a horse from P for the use of the firm. He injured the horse by negligent driving. What are the rights of P?

CHAPTER VII

ADJUSTMENT OF THE RIGHTS OF CREDITORS

HAMSMITH *v.* ESPY

13 Iowa Reports 439 (1862)

Hamsmith commenced his action against "Thomas S. Espy, Charles Baker, and John Robinson, doing business as partners, in the name and style of Espy, Barker & Robinson," upon a note made in the copartnership name. After judgment against defendants, the cause was brought into this court, and at the June term, 1861, a judgment was rendered against them in their individual names, as well their sureties on the appeal bond. An execution was issued, and levied upon two lots in Fort Madison, one of them belonging to the firm, and the other the individual property of Espy, who now moves to set aside this sale of his lot, by showing that there was other firm property, of which the sheriff, and all persons at the sale, had notice, amply sufficient to satisfy the writ, and which was pointed out to him before the levy.

WRIGHT, J. We are aware of the rule in equity, that partnership property should pay firm debts, and individual property individual debts. But suppose a judgment is rendered against persons composing a firm, in their individual names, if individual property is sold under an execution issued thereon, is the sale invalid, though there may be partnership means? We think not. The judgment is several, the writ runs against defendants, as individuals. No step further is necessary in the first instance (as by *scire facias* or the like), to make individual property liable, and it is not irregular to levy and sell that which the writ commands the officer to seize. By this writ, he does not know of a joint liability, and his simple duty, primarily, is, to make the money from property belonging to either of the defendants named. A creditor of either in a proper case, in equity, by a showing of all the facts, can compel a resort to the partnership assets. But if this is not done the individual debtor cannot complain of the illegality of the sale.

Our code changes the common law, in providing that a partnership may be sued in its firm name. If thus sued, a *scire facias* is necessary,

in order to reach individual property. If, however, a plaintiff follows, as he may, the common-law requirement, of giving the individual names, and thus serving and suing all, he may take the property of either partner in satisfaction of this writ. In such a case a *scire facias* is not necessary.

Motion refused.

QUESTIONS

1. C recovers a judgment against the firm of Smith and Brown. In what different ways can C secure satisfaction of the judgment?
2. (*a*) X owes the firm $500. (*b*) Y owes $500 to Smith individually. Can C reach either of these claims in the satisfaction of his judgment?
3. C sues the firm of A, B, and D on a firm debt but does not join D in the action. A and B object to the non-joinder. What decision?
4. A and B do not object to the non-joinder of D. C recovers his judgment and causes a levy to be made upon the property of D. Is the levy valid?
5. C recovers a judgment of $500 on a firm claim against A, B, and D. C secures satisfaction of the judgment from the individual estate of D. What are D's rights against A and B?
6. The satisfaction of C's judgment will exhaust the firm assets. A, who has no individual estate, claims that a part of his interest in the firm property is exempt by virtue of a statute which provides that a debtor is permitted to hold $1,500 free from the claims of his creditors. Is his contention valid?

SANBORN *v.* ROYCE

132 Massachusetts Reports 594 (1882)

Tort, by Charles H. Sanborn and Charles H. Packard, copartners doing business under the firm name of Sanborn and Packard, for breaking and entering the plaintiffs' close in Boston, and taking and carrying away certain articles of personal property belonging to them, with a count in tort for the conversion of the same. The defendant, a constable of the city of Boston, justified under a writ against Packard, by virtue of which he attached the property in question.

At the trial in the Superior Court, before PUTNAM, J., it appeared that the plaintiffs were copartners in the grocery and provision business, and the defendant was notified of this fact at the time of the attachment; that on May 3, 1879, a creditor of Packard, individually, sued out a writ against him, and delivered it to the defendant who by virtue of it, on May 31, 1879, attached all the property of the partnership, placed a keeper over the same, and afterward on the same

day, by order of the plaintiffs' attorney, withdrew the keeper, and removed the goods, and on June 3, 1879, released the attachment and left the goods where he found them, and the writ against Packard was duly entered in court on June 19, 1879, and is now pending.

Upon these facts, the defendant contended, and asked the judge to rule, that he was justified, by virtue of said writ, in what he did with reference to the property; and that the plaintiffs could not maintain their action. The judge declined, and ruled otherwise. The jury returned a verdict for the plaintiffs; and the defendant alleged exceptions.

C. ALLEN, J. The question presented in this case has been several times alluded to, but has never been decided in Massachusetts, though it has been the subject of much discussion and conflicting opinion elsewhere. It has been declared, that the real and actual interest of each partner in the partnership stock is the net balance which will be coming to him after payment of all the partnership debts, and a just settlement of the account between himself and his partner. *Peck* v. *Fisher*, 7 Cush. 386. This doctrine is in accordance with the great body of modern decisions. It is also declared in *Allen* v. *Wells*, 22 Pick. 450, that a separate creditor can only take and sell the interest of the debtor in the partnership property, being his share upon a division of the surplus, after discharging all demands upon the partnership. This rule also is supported by a great weight of authority. It is rather remarkable, in view of the multitude of cases in which the question has arisen, and the conflict of opinion which has existed, that the manner in which a creditor of one member of a firm may apply that member's interest in the copartnership to the payment of his debt, has not been more often the subject of legislation. The rights of parties, however, in this state, as in almost all the other states of the Union, are still left to be worked out as well as possible by the courts. There is an entire concurrence of opinion among the leading text-writers, in recent times, that courts of law cannot adequately deal with the subject. 3 Kent, Com. 65, n. Story *Partnerships*, secs. 262, 312. Collyer, *Partnership* (6th ed.), section 793. Lindley sums up what he has to say with the remark: "The truth, however, is that the whole of this branch of the law is in a most unsatisfactory condition, and requires to be put on an entirely new footing." Lindley, *Partnerships* (4th ed.), section 694.

It is sufficient for the purposes of the present case to decide, as we do, that the seizure and actual removal of specific chattels of a

partnership, on *mesne* process or execution against one member thereof for his private debt, and the exclusion of the firm from the possession of its property, are a trespass. The authorities in support of this proposition seem to us more in accordance with just legal principles, than those which are opposed to it. *Bank* v. *Carrollton Railroad*, 11 Wall. 624, 626, 629.

Exceptions overruled.

QUESTIONS

1. C recovers a judgment against D who is a member of a partnership. In what different ways can C secure satisfaction of his judgment?
2. D has no property other than his interest in the partnership. How can C reach this interest in satisfaction of his judgment?
3. C causes an execution to issue on the judgment and sheriff seizes enough of the partnership property to satisfy the judgment. The partnership sues the sheriff in trespass. What decision?
4. The sheriff levies upon and takes possession of all the partnership property. The partnership sues the sheriff in trespass. What decision?
5. Assuming that the sheriff has made a valid levy on the interest of D in the firm, how does he proceed to sell it? What is the effect of a sale of D's interest? What does the purchaser of the interest get?

RODGERS *v.* MERANDA

7 Ohio State Reports 180 (1857)

This is a petition in error to reverse the judgment of the common pleas of Clark County.

The original proceeding was a petition for an order of distribution of the separate or individual assets of an insolvent debtor, as between separate and partnership creditors.

It appears from the record that about the thirteenth of June, 1854, Peter Murray, an insolvent debtor, made an assignment of all his estate, real and personal, to the plaintiff, in trust for the payment of his individual creditors, in proportion to the amount of their respective demands. Though possessed of a large and valuable estate, it had been found insufficient to pay his separate debts and liabilities in full. At the date of his failure and assignment, he was a partner of John W. Dever, in a mercantile firm, under the name and style of Dever & Murray, which firm had also become insolvent, and likewise Dever; and the firm had made an assignment of the partnership property and assets, about the same time, to John

Meranda, one of the defendants, in trust for the payment of the joint debts or liabilities of the firm.

In this condition of affairs, the partnership creditors, although they have filed their claims with the assignee of the firm for their distributive shares out of the partnership property, claim the right to be admitted to a participation in the dividends of the separate estate of Murray, *pari passu* with his individual creditors; while the latter deny the right, and insist that his separate estate shall be applied to the satisfaction of his individual debts in preference to his partnership debts.

It appears further, that Murray, besides advancing his part of the capital of the firm, also loaned money to the firm to a large amount, for which he held the obligations of the firm; which obligations, by the assignment of Murray, came into the hands of the plaintiff, who has presented the same to the assignee of the firm, and claims to have the same paid out of the assets of the firm, *pari passu* with the other partnership debts. The other creditors resist this, and plaintiff asks an order of distribution to that effect, out of the partnership assets.

Defendants demurred to the petition. The court below sustained the demurrer, and gave judgment in favor of the defendants. And this petition in error is filed to review and reverse that judgment.

Bartley, C. J. Two questions are presented for determination in this case. The first is, whether in the distribution of the assets of insolvent partners, where there are both individual and partnership assets, the individual creditors of a partner are entitled to be first paid out of the individual effects of their debtor, before the partnership creditors are entitled to any distribution therefrom. It is well settled that, in the distribution of the assets of insolvent partners, the partnership creditors are entitled to a priority in the partnership effects; so that the partnership debts must be settled before any division of the partnership funds can be made among the individual creditors of the several partners. This is incident to the nature of partnership property. It is the right of a partner to have the partnership property applied to the purposes of the firm; and the separate interest of each partner in the partnership property, is his share of the surplus after the payment of the partnership debts. And this rule, which gives the partnership creditors a preference in the partnership effects, would seem to produce, in equity, a corresponding and correlative rule, giving a preference to the individual creditors of a partner in

his separate property; so that partnership creditors can, *in equity*, only look to the surplus of the separate property of a partner, after the payment of his individual debts; and, on the other hand, the individual creditors of a party can, in like manner, only claim distribution from the debtor's interest in the surplus of the joint fund, after the satisfaction of the partnership creditors. The correctness of this rule, however, has been much controverted; and there has not been always a perfect concurrence in the reasons assigned for it by those courts which have adhered to it. By some, it has been said to be an arbitrary rule, established from considerations of convenience; by others that it rests on the basis that a primary liability attaches to the fund on which the credit was given—that in contracts with a partnership, credit is given on the supposed responsibility of the firm; while in contracts with a partner as an individual, reliance is supposed to be placed on his separate responsibility. 3 Kent, Com. 65. And again, others have assigned as a reason for the rule, that the joint estate is supposed to be benefited to the extent of every credit which is given to the firm, and that the separate estate is, in like manner, presumed to be enlarged by the debts contracted by the individual partner; and that there is consequently a clear equity in confining the creditors, as to preferences, to each estate respectively, which has been thus benefited by their transactions. 1 Har. & Gill. 96. But these reasons are not entirely satisfactory. So important a rule must have a better foundation to stand upon than mere considerations of conveniences and practically it is undeniable, that those who give credit to a partnership, look to the individual responsibility of the partners, as well as that of the firm; and also, those who contract with a partner in his separate capacity, place reliance on his various resources or means, whether individual or joint. And inasmuch as individual debts are often contracted to raise means which are put into the business of a partnership and also partnership effects often withdrawn from the firm and appropriated to the separate use of the partners, it cannot be practically true, that the separate estate has been benefited to the extent of every credit given to each individual partner, nor that the joint estate has retained from the separate estate of each partner, the benefit of every credit given to the firm. Unsatisfactory reasons may weaken confidence in a rule which is well founded.

What then is the true foundation of the rule, which gives the individual creditor a preference over the partnership creditor, in the distribution of the separate estate of a partner? To say that it is

a rule of general equity, as has been sometimes said, is not a satisfactory solution of the difficulty; for the very question is, whether it be a rule of equity or not. In the distribution of the assets of insolvents, equality is equity; and to say that the rule which gives the individual creditor a preference over the partnership creditor in the separate estate of a partner, is a rule of equality, does not still aid the subject of difficulty. For, leaving the rule to stand, which gives the preference to the joint creditors in the partnership property, and perfect equality between the joint and individual creditors, is, perhaps, rarely attainable. That it is, however, more equal and just, as a general rule, than any other which can be devised, consistently with the preference to the partnership creditors in the joint estate, cannot be successfully controverted. It originated as a consequence of the rule of priority of partnership creditors in the joint estate, and for the purpose of justice, became necessary as a correlative rule. With what semblance of equity could one class of creditors, in preference to the rest, be exclusively entitled to the partnership fund, and, concurrently with the rest, entitled to the separate estate of each partner? The joint creditors are no more meritorious than the separate creditors; and it frequently happens, that the separate debts are contracted to raise means to carry on the partnership business. Independent of this rule, the joint creditors have, as a general thing, a great advantage over the separate creditors. Besides being exclusively entitled to the partnership fund, they take their distributive share in the surplus of the separate estate *of each of the several* partners, after the payment of the separate creditors of each. It is a rule of equity, that where one creditor is in a situation to have two or more distinct securities or funds to rely on, the court will not allow him, neglecting his other funds, to attach himself to one of the funds to the prejudice of those who have a claim upon that, and no other to depend on. And besides the advantage, which the joint creditors have, arising from the fact that the partnership fund is usually much the largest, as men in trade, in a great majority of cases, embark their all, or the chief part of their property, in it; and besides their distributive rights in the surplus of the separate estate of the other partners, the joint creditors have a degree of security for their debts and facilities for recovering them, which the separate creditors have not; they can sell both the joint and the separate estate on an execution, while the separate creditor can sell only the separate property and the interest in the joint effects that may remain to the

partners, after the accounts of the debts and effects of the firm are taken, as between the firm and its creditors, and also as between the partners themselves. With all these advantages in favor of partnership creditors, it would be grossly inequitable to allow them the exclusive benefit of the joint fund, and then a concurrent right with individual creditors to an equal distribution in the separate estate of each partner. What equality and justice is there in allowing partnership creditors, who have been paid 80 per cent on their debts, out of the joint fund, to come in *pari passu* with the individual creditors of one of the partners, whose separate property will not pay 20 per cent to his separate creditors? How could that be said to be an equal distribution of the assets of insolvents among their creditors?

It is true, that an occasional case may arise where the joint effects are proportionably less than the separate assets of an insolvent partner. But, as a general thing, a very decided advantage is given to the partnership creditors, notwithstanding this preference of the individual creditors in the separate property. And that advantage, arising out of the nature of a partnership contract, is unavoidable. Some general rule is necessary; and that must rest on the basis of the unalterable preference of the partnership creditors in the joint effects, and their further right to some claim in the separate property of each of the several partners. The preference, therefore, of the individual creditors of a partner, in the distribution of his separate estate, results, as a principal of equity, from the preference of partnership creditors in the partnership funds, and their advantages in having different funds to resort to, while the individual creditors have but the one. It has been argued that partnership contracts are *several* as well as *joint*, and consequently have an equal legal right with separate creditors upon the individual property of a partner. But the right of partnership creditors against the separate property of individual partners in *proceedings at law*, is not in controversy. The question here relates to the relative equitable rights of two classes of creditors in the distribution of the estates of insolvents. Much of the confusion upon this subject has probably arisen from confounding the abstract rights of creditors in proceedings at law, with their relative rights to an equitable adjustment in marshaling the assets of insolvents in chancery.

In the case before us, however, it is not pretended that the firm obtained the borrowed money from Murray improperly. The separate creditors of Murray, therefore, are not, on account of this claim

for money lent by Murray to the firm, entitled to participate with the partnership creditors in the distribution of the joint effects.

'Judgment of the common pleas reversed; and ordered that the separate effects of Peter Murray be distributed pro rata first among his individual creditors, before any application thereof be made to the payment of the partnership debts of Dever & Murray; and that the partnership effects be applied first to the payment of the partnership debts, irrespective of the claim of the partner, Peter Murray, for money loaned by him to the firm.

QUESTIONS

1. From this case it appears that equity has a system, entirely different from that of the law, in distributing the assets of the firm and the assets of the members among the various claimants. Why should this be so? How are the affairs of the partnership brought into equity?
2. What are the rights of firm creditors with respect to firm assets in equity? What are their rights with respect to individual assets?
3. What are the rights of individual creditors with respect to individual assets in equity? With respect to firm assets?
4. Suppose that there are no firm assets at all, what are the rights of the firm creditors with respect to the individual assets?
5. The firm of Smith, Jones, and Brown is insolvent. It has assets amounting to $12,500. It owes C, $5,000; D, $6,000; E, $3,500; and Smith, one of the partners, $1,000. Smith is insolvent. His individual assets amount to $5,000. He owes X, $1,500; Y, $2,500; Z, $3,500; and the firm, $1,000. Jones has individual assets amounting to $6,000 and owes M the sum of $4,000. Brown has no individual assets at all and owes P the sum of $3,000. The affairs of the partnership are being adjusted in equity. How will the various assets be distributed between the various claimants?

HOSPES *v.* NORTHWESTERN MANUFACTURING AND CAR COMPANY

48 Minnesota Reports 174 (1892)

MITCHELL, J. This appeal is from an order overruling a demurrer to the so-called "supplemental complaint" of the Minnesota Thresher Manufacturing Co. The Northwestern Manufacturing & Car Co. was a manufacturing corporation organized in May, 1882. Upon the complaint of a judgment creditor (Hospes & Co.), after return of execution unsatisfied, judgment was rendered in May, 1884, sequestrating all its property, things in action, and effects, and appointing

a receiver of the same. This receivership still continues, the affairs of the corporation being not yet fully administered; but it appears that it is hopelessly insolvent, and that all the assets that have come into the hands of the receiver will not be sufficient to pay any considerable part of the debts. The Minnesota Thresher Manufacturing Co., a corporation organized in November, 1884, as creditor became a party to the sequestration proceeding, and proved its claims against the insolvent corporation. In October, 1889, in behalf of itself and all other creditors who have exhibited their claims, it filed this complaint aganst certain stockholders (these appellants) of the car company, in pursuance of an order of court allowing it to do so, and requiring those thus impleaded to appear and answer the complaint. The object is to recover from these stockholders the amount of certain stock held by them, but alleged never to have been paid for. What was said in Meagher's case, *ante*, page 158, 50 N.W. Rep. 1114 (just decided) is equally applicable here as to the right to enforce such a liability in the sequestration proceeding upon the petition or complaint of creditors who have become parties to it. There is nothing in this practice inconsistent with what was decided in *Minnesota Thresher Manufacturing Co.* v. *Langdon*, 44 Minn. 37 (46 N.W. Rep. 310). The complaint is not the commencement of an independent action by creditors in their own behalf, antagonistic to the rights of the receiver, but is filed in the sequestration proceeding itself, and in aid of it.

The principal question in the case is whether the complaint states facts showing that the thresher company, as creditor, is entitled to the relief prayed for; or, in other words, states a cause of action. Briefly stated, the allegations of the complaint are that on May 10, 1882, Seymour, Sabin & Co. owned property of the value of several million dollars, and a business then supposed to be profitable. That in order to continue and enlarge this business, the parties interested in Seymour, Sabin & Co., with others, organized the car company, to which was sold the greater part of the assets of Seymour, Sabin & Co. at a valuation of $2,267,000, in payment for which there were issued to Seymour, Sabin & Co., shares of the preferred stock of the car company of the par value of $2,267,000, it being then and there agreed by both parties that this stock was in full payment of the property thus purchased. It is further alleged that the stockholders of Seymour, Sabin & Co. and the other persons who had agreed to become stockholders in the car company, were then desirous of issuing to

themselves, and obtaining for their own benefit, a large amount of common stock of the car company, "without paying therefor, and without incurring any liability thereon or to pay therefor"; and for that purpose, and "in order to evade and set at naught the laws of this state," they caused Seymour, Sabin & Co. to subscribe for and agree to take common stock of the car company of the par value of $1,500,000. That Seymour, Sabin & Co. thereupon subscribed for that amount of the common stock, but never paid therefor any consideration whatever, either in money or property. That thereafter these persons caused this stock to be issued to D. M. Sabin as trustee, to be by him distributed among them. That it was so distributed without receipt by him or the car company, from anyone, of any consideration whatever, but was given by the car company and received by these parties entirely "gratuitously." The car company was, at this time, free from debt, but afterward became indebted to various persons for about $3,000,000. The thresher company, incorporated after the insolvency and receivership of the car company, for the purpose of securing possession of its assets, property, and business, and therewith engaging in and continuing the same kind of manufacturing, prior to October 27, 1887, purchased and became the owner of unsecured claims against the car company, "bona fide, and for a valuable consideration," to the aggregate amount of $1,703,000. As creditor, standing on the purchase of these debts, which were contracted after the issue of this "bonus" stock, the thresher company files this complaint to recover the par value of the stock as never having been paid for. The complaint does not allege what the consideration of these debts was, nor to whom originally owing, nor what the intervener paid for them, nor whether any of the original creditors trusted the car company on the faith of the bonus stock having been paid for. Neither does it allege that either the thresher company or its assignors were ignorant of the bonus issue of stock, nor that they or any of them were deceived or damaged in fact by such issue, nor that the bonus stock was of any value. Neither is there any traversable allegation of any actual fraud or intent to deceive or injure creditors. A desire to get something without paying for it, and actually getting it, is not fraudulent or unlawful if the donor consents, and no one else is injured by it; and the general allegation that it was done "in order to evade and set at naught the laws of the state" of itself amounts to nothing but a mere conclusion of law. As a creditor's bill, in the ordinary sense,

the complaint is manifestly insufficient. The thresher company, however, plants itself upon the so-called "trust-fund" doctrine, that the capital stock of a corporation is a trust fund for the payment of its debts; its contention being that such a "bonus" issue of stock creates, in case of the subsequent insolvency of the corporation, a liability on part of the stockholder in favor of creditors to pay for it, notwithstanding his contract with the corporation to the contrary.

This "trust-fund" doctrine, commonly called the "American doctrine," has given rise to much confusion of ideas as to its real meaning, and much conflict of decision in its application. To such an extent has this been the case that many have questioned the accuracy of the phrase, as well as doubted the necessity or expediency of inventing any such doctrine. While a convenient phrase to express a certain general idea, it is not sufficiently precise or accurate to constitute a safe foundation upon which to build a system of legal rules. The doctrine was invented by JUSTICE STORY in *Wood* v. *Dummer*, 3 Mason, 308, which called for no such invention, the facts in that case being that a bank divided up two-thirds of its capital among its stockholders without providing funds sufficient to pay its outstanding bill holders. Upon old and familiar principles this was a fraud on creditors. Evidently all that the eminent jurist meant by the doctrine was that corporate property must be first appropriated to the payments of the debts of the company before there can be any distribution of it among stockholders—a proposition that is sound upon the plainest principles of common honesty. In *Fogg* v. *Blair*, 133 U.S. 534, 541 (10 Sup. Ct. Rep. 338), it is said that this is all the doctrine means. The expression used in *Wood* v. *Dummer* has, however, been taken up as a new discovery, which furnished a solution of every question on the subject. The phrase that "the capital of a corporation constitutes a trust fund for the benefit of creditors" is misleading. Corporate property is not held in trust, in any proper sense of the term. A trust implies two estates or interests—one equitable and one legal; one person, as trustee, holding the legal title, while another, as the *cestui que trust*, has the beneficial interest. Absolute control and power of disposition are inconsistent with the idea of a trust. The capital of a corporation is its property. It has the whole beneficial interest in it, as well as the legal title. It may use the income and profits of it, and sell and dispose of it, the same as a natural person. It is a trustee for its creditors in the same sense and to the same extent as a natural person, but no further.

There is also much confusion in regard to what the "trust fund" doctrine applies. Some cases seem to hold that unpaid subscribed capital is a trust fund, while other assets are not, that is, so long as the subscription is unpaid it is held in trust by the corporation, but when once paid in, it ceases to be a trust fund; while other cases hold that, paid or unpaid, it is all a trust fund. The first seems to be the rule laid down in *Sawyer* v. *Hoag*, 17 Wall. 610, in which the "trust fund" doctrine was first squarely announced by the court with all the vigor and force characteristic of the great jurist who wrote the opinion. In that case a stockholder in an insurance company had given his note, as the court found the fact to be, for 85 per cent of his subscription to the stock of the company. After the company had become bankrupt, and the stockholder knew the fact, he brought up a claim against the company for one-third its face, and in a suit by the assignee in bankruptcy on his note set up this claim as an offset. That this would have been a fraud on the bankrupt act, or at least a moral fraud on policyholders, is quite apparent without invoking the "trust-fund" doctrine; and, if the note for unpaid stock was a trust fund, there could have been no offset, whether the company was solvent or insolvent. In the opinion it is said that, if the subscription had been paid by the note or otherwise, the note ceased thereby to be a trust fund to which creditors can look, and becomes ordinary assets, with which directors may deal as they choose. But in *Upton* v. *Tribilcock*, 91 U.S. 45, it is stated: "The capital paid in and promised to be paid in is a fund which the trustees cannot squander or give away." While in *Sanger* v. *Upton*, *Id.* 56, it is said: "When debts are incurred a contract arises with the creditors that it [the capital] shall not be withdrawn or applied otherwise than upon their demands until such demands are satisfied." And in the same connection it is distinctly stated that there is no difference between assets paid in and subscriptions; that "unpaid stock is as much a part of this pledge and as much a part of the assets of the company as the cash which has been paid in upon it. Creditors have the same right to look to it as to anything else, and the same right to insist upon its payment as upon the payment of any other debt due to the company. *As regards creditors, there is no distinction between such a demand and any other asset which may form a part of the property and effects of the corporation.*" This language is quoted and approved in *County of Morgan* v. *Allen*, 103 U.S. 498, 508. It would seem clear that this is the correct statement of the law. The capital (not the mere

share certificates) means all the assets, however invested. If a subscriber gives his note for his stock, that note is no more and no less a trust fund than the money would have been if he had paid cash down. Capital cannot change from a trust to not a trust by a mere change of form. It is either all a trust or all not a trust, and the "trust-fund" rule, whatever that be, must apply to all alike, and in the same way. If the assets of a corporation are given back to stockholders, the result is the same as if the shares had been issued wholly or partly as a bonus. The latter is merely a short cut to the same result. So with dividends paid out of the capital, voluntary conveyances, stock paid in overvalued property, all are forms of one and the same thing, all reaching the same result (a disposition of corporate assets), which may or may not be a fraud on creditors, depending on circumstances. This much being once settled, the solution of the question when a subsequent creditor can insist on payment of stock issued as paid up, but not in fact paid for, or not paid for at par, becomes as we shall presently see, comparatively simple.

Another proposition which we think must be sound is that creditors cannot recover on the ground of contract when the corporation could not. Their right to recover in such cases must rest on the ground that the acts of the stockholders with reference to the corporate capital constitutes a fraud on their rights. We have here a case where the contract between the corporation and the takers of the shares was specific that the shares should not be paid for. Therefore unlike many of the cases cited, there is no ground for implying a promise to pay for them. The parties have explicitly agreed that there shall be no such implication, by agreeing that the stock shall not be paid for. In such a case the creditors undoubtedly may have rights superior to the corporation, but these rights cannot rest on the implication that the shareholder agreed to do something directly contrary to his real agreement, but must be based on tort or fraud, actual or presumed. In England, since the act of 1877, there is an implied contract created by statute that "every share in any company shall be deemed and be taken to have been issued and to be held subject to the payment of the whole amount thereof in cash." This statutory contract makes every contrary contract void. Such a statute would be entirely just to all, for everyone would be advised of its provisions, and could conduct himself accordingly. And in view of the fact that "watered" and "bonus" stock is one of the greatest abuses connected with the management of modern corporations, such a law might, on grounds of

public policy, be very desirable. But it is a matter for the legislature, and not for the courts. We have no such statute; and even if the law of 1873, under which the car company was organized, impliedly forbids the issue of stock not paid for, the result might be that such issue would be void as *ultra vires*, and might be canceled, but such a prohibition would not of itself be sufficient to create an implied contract, contrary to the actual one, that the holder should pay for his stock.

It is well settled that an equity in favor of a creditor does not arise absolutely and in every case to have the holder of "bonus" stock pay for it contrary to his actual contract with the corporation. Thus no such equity exists in favor of one whose debt was contracted prior to the issue, since he could not have trusted the company upon the faith of such stock. *First National Bank* v. *Gustin, etc., Mining Co.*, 42 Minn. 327 (44 N.W. Rep. 198); *Coit* v. *Gold Amalgamating Co.*, 119 U.S. 343 (7 Sup. Ct. Rep. 231); *Handley* v. *Stutz*, 139 U.S. 417, 435 (11 Sup. Ct. Rep. 530). It does not exist in favor of a subsequent creditor who has dealt with the corporation with full knowledge of the arrangement by which the "bonus" stock was issued, for a man cannot be defrauded by that which he knows when he acts. *First National Bank* v. *Gustin, etc., Mining Co., supra.* It has also been held not to exist where stock has been issued and turned out at its full market value to pay corporate debts. *Clark* v. *Bever, supra.* The same has been held to be the case where an active corporation, whose original capital has been impaired, for the purpose of recuperating itself, issues new stock, and sells it on the market for the best price obtainable, but for less than par (*Handley* v. *Stutz, supra*); although it is difficult to perceive, in the absence of a statute authorizing such a thing (of which everyone dealing with the corporation is bound to take notice), any difference between the original stock of a new corporation and additional stock issued by a "going concern." It is difficult, if not impossible, to explain or reconcile these cases upon the "trust-fund" doctrine, or, in the light of them, to predicate the liability of the stockholder upon that doctrine. But by putting it upon the ground of fraud, and applying the old and familiar rules of law on that subject to the peculiar nature of the corporation and the relation which its stockholders bear to it and to the public, we have at once rational and logical ground on which to stand. The capital of a corporation is the basis of its credit. It is a substitute for the individual liability of those who own its stock. People deal with it and give it credit on

the faith of it. They have a right to assume that it has a paid-in capital to the amount which it represents itself as having; and if they give it credit on the faith of that representation, and if the representation is false, it is a fraud upon them; and, in case the corporation becomes insolvent, the law, upon the plainest principles of common justice, says to the delinquent stockholder, "Make that representation good by paying for your stock." It certainly cannot require the invention of any new doctrine in order to enforce so familiar a rule of equity. It is the misrepresentation of fact in stating the amount of capital to be greater than it really is that is the true basis of the liability of the stockholder in such cases; and it follows that it is only those creditors who have relied, or who can fairly be presumed to have relied, upon the professed amount of capital, in whose favor the law will recognize and enforce an equity against the holders of "bonus" stock. This furnishes a rational and uniform rule, to which familiar principles are easily applied, and which frees the subject from many of the difficulties and apparent inconsistencies in which the "trust-fund" doctrine has involved it; and we think that, even when the trust-fund doctrine has been invoked, the decision in almost every well considered case is readily referable to such a rule.

Order reversed.

QUESTIONS

1. C recovers a judgment against the D Company for $5,000. Against which of the following may C proceed in securing satisfaction of his judgment: (*a*) Real and personal property owned by the corporation? (*b*) Franchise to be a corporation? (*c*) Franchise to operate a street railway? (*c*) Money owed by X to the corporation?
2. C's execution is returned unsatisfied. He finds that the corporation has transferred a part of its assets to B for the purpose of hindering, delaying, and defrauding creditors. What are the rights of C under the circumstances?
3. The corporation gratuitously issued ten shares of stock to S. The certificate of stock represented that the stock was fully paid for. The corporation later became insolvent. C, a judgment creditor of the corporation, having exhausted his legal remedies, brings a bill in equity against S, asking that he be compelled to pay the corporation the par value of his stock. What decision?
4. B, ignorant that the stock was gratuitously issued to S, bought it, paying therefor half its par value. What are the rights of C, if any, against B?
5. The D Company for several years conducted a losing business. The corporation, having unissued stock, decided to sell it below par value. S bought ten shares of stock under this issue at half its par value. What are the rights of the corporation against S?

GRESS *v.* KNIGHT

135 Georgia Reports 60 (1910)

Proceedings for the appointment of receivers for the Bank of Waycross. A. H. Knight and others were appointed receivers, and M. C. Gress and others intervene, praying for a rescission of their subscription to the stock of the bank. Demurrers to the interventions were sustained, and interveners bring error.

The rescission is sought on the ground of the false and fraudulent character of the representations made by the bank and its agents to the interveners to induce the taking of the stock. Some had paid for the stock, some had given notes therefor. The prayers were for a rescission and other equitable relief. General and special demurrers were filed. They were sustained and the interventions dismissed; and the interveners each excepted.

LUMPKIN, J. In England it is settled that after the commencement of winding up proceedings against a corporation an application to be relieved from liability as a shareholder on the ground of fraud practiced upon him by agents of the company in procuring the subscription comes too late. *Oakes* v. *Turquand*, L.R. 2 H.L. 325; *Stone* v. *City & County Bank*, 3 C.P. Div. 282. By the companies act of 1862 (Statutes at Large; 25 & 26 Vict. 434, secs. 23, 26, 37, 38) every company was required to keep a register of members or shareholders, showing the name and address of each, and the date of becoming a member and ceasing to be a member, and a penalty was provided for a failure to do so. Once a year a list was required to be made up and forwarded to the public registrar. The register of members was made prima facie evidence of what it was required to contain. On winding up, every present and past member who had not ceased to be a member for a year was liable to contribute to the payment of debts. How far the English decisions may have been affected by the requirements of that act need not be considered.

In this state there is no similar law. The courts must determine the question by applying general principles of equity. A stockholder occupies a threefold relation: First, to the corporation itself; second, to other stockholders; and, third, to creditors of the corporation. Fraud does not render a contract absolutely void, but voidable. It remains valid until repudiated or avoided. As between a stockholder and the corporation, unless special circumstances alter the case, the general rule that contracts obtain by fraud may be avoided by the

party defrauded applies to a stock subscription induced by the fraud of the company through its authorized agents. So also where only the rights of other shareholders are affected; the company being solvent and a "going concern." These matters are of comparatively easy solution. But, where the rights of creditors are involved, the question is one of greater difficulty.

Some American decisions have announced in general terms the rule laid down by the English courts; but in most of them additional circumstances existed, such as receiving benefits after knowledge, or notice of the fraud, acts done after notice or knowledge, inconsistent with a disaffirmance, *laches*, estoppel, the intervening of rights of innocent third parties, or the like. Thus in *Chubb* v. *Upton*, 95 U.S. 665, 667 (24 L. Ed. 523), Mr. JUSTICE HUNT said: "It has been several times adjudged in this court that in an action by such assignee to recover unpaid subscriptions upon stock in such an organization the defense of false and fraudulent representations inducing such subscription cannot be set up, especially when the subscriber has not been vigilant in discovering such fraud, and in repudiating his contract."

It cannot be easily determined just how far a rule laid down in general terms would be applied in the absence of the facts added to it under an "especially." In the case just cited Chubb was sued by an assignee in bankruptcy of the company. He sought to set up irregularities and informalities in the increase of capital stock to which he became a subscriber, and also fraud in the procurement of his subscription. It appeared that he was president of a branch of the company, took part in its meetings, paid money on his stock, and at one time gave a proxy to another person to attend and vote at a stockholders' meeting at the main office. He made no effort to cancel his subscription. The company incurred liabilities, and was adjudicated a bankrupt about fifteen months after his subscription. Clearly he should not have been relieved.

In *Upton* v. *Tribilcock*, 91 U.S. 45, 23 L. Ed. 203, the shareholder had delayed repudiating his subscription for three years and until an assignee in bankruptcy had been appointed, and there were other circumstances showing *laches*. Discussions of the subject will be found in 2 Thompson on *Corporations*, sections 1440, 1449; *Upton* v. *Englehart*, 3 Dill. 496, Fed. Cas. No. 16, 800; *Farrar* v. *Walker*, 3 Dill. 506, Fed. Cas. No. 4679; *Newton National Bank* v. *Newbegin*, 74 Fed. 135, 20 C.C.A. 339, 33 L.R.A. 727, and note; *Parker* v.

Thomas (Ind.) 81 Am. Dec. 385, 401, note. A number of American decisions are to the effect that where one subscribes to stock and the company proceeds to do business, incurs liabilities and later fails and is adjudged a bankrupt, or its assets are placed in the hands of a receiver for the purpose of winding it up, no rescission will be allowed, unless under exceptional circumstances. Thompson, *Corporations*, section 1450.

When a person becomes a stockholder of a corporation, he becomes a part of it. Its agents are in a sense his agents. They go out and deal with the public. If through their dealings debts are incurred, assuming both the stockholder and the creditor to be innocent and that one must suffer, the former, who put it in the power of the agents to do the wrong, should suffer rather than third parties who dealt with such agents. Civ. Code, 1895, section 3940. As to creditors whose claims arose after the stockholders became such, their rights are superior to any right of rescission. The status of a stockholder relative to creditors who became such after he took the stock is not in all respects identical with that relative to antecedent creditors. As to creditors whose debts were created before he took the stock, questions of *laches*, acts inconsistent with rescission, estoppel, etc., might arise. The new stockholders may have permitted the increase of indebtedness and the lessening of the assets with which to pay.

It does not affirmatively appear in this case whether debts were created after the interveners became stockholders, or their amount. There was originally an allegation in each intervention on information and belief that all the creditors were the same as those existing before the stock was issued; but this was stricken out by amendment. We do not think that it can be said as matter of law that such *laches* or conduct on the part of the interveners affirmatively appears on the face of the respective interventions so as to authorize us to declare that no rescission could be had, whatever may be developed by the evidence. It was error to sustain the general demurrers. If the interventions were not otherwise demurrable, they did not become so by reason of failing to negative the existence of any debts incurred after they took their stock. That was matter of defense to the intervention under the facts alleged.

Most of the special demurrers were not meritorious. These were not original suits, but interventions in the main suit, where the assets, books, and memoranda were in the hands of the receivers. The special demurrers, if they were all sustained, would have required

the attaching to each intervention of a large part of the items from such books, in order to show insolvency, or that the representations that there were no overdrafts and that there was a large surplus, etc., were false. We do not think this was necessary. When the facts are shown, it can be made to appear whether a fraud was really perpetrated on each of the interveners, whether there was any lack of diligence in discovering such fraud or unreasonable delay in seeking relief after its discovery, whether there was any active participation by the interveners in the management of the corporation, or whether debts had been incurred after the intervener became a stockholder, which either gave corporate creditors superior equitable rights or estopped the intervener from denying that he was a stockholder, and generally whether his conduct was such as to prevent relief.

Judgment reversed.

QUESTIONS

1. When a stockholder has been induced by fraud to subscribe for stock in a corporation, why should there be any doubt about his right to rescind the subscription?
2. S subscribed for stock in a corporation to be organized with power to conduct a realty investment business. The corporation carried the business on for a while and became insolvent. C, a judgment creditor of the corporation, is proceeding against S to collect his unpaid subscription. S contends that he cannot be held because the corporation did not sufficiently comply with the law to become a *de jure* corporation. What decision?
3. S subscribed for stock on condition that the corporation should locate its principal office in the city of X. C is proceeding against S to collect his unpaid subscription. S contends that he is not liable because the corporation did not locate its principal office in X. What decision?
4. C is proceeding against S on his unpaid stock subscription. S asks that he be allowed a set-off against the claim in respect to a sum of money owed by the corporation to him. What decision?
5. In defense to the proceedings of C, S sets up the statue of limitations as a defense. What decision?

TAYLOR *v.* FANNING

87 Minnesota Reports 53 (1902)

COLLINS, J. The plaintiff in this case was also plaintiff in *Taylor* v. *Mitchell*, 80 Minn. 492, 82 N.W. 418. Five of the defendants in that case are the same as in this. The facts do not differ particularly, except that the lien on corporate real property was there secured by

means of a mortgage, while here a lien upon the same property was secured through a judgment. The defendant corporation was insolvent prior to May 30, 1895, and thereafter continued to be. These defendants were six of the seven persons constituting its board of directors, and, claiming that the corporation was indebted to them on account of their previous payment of certain of its debts, a resolution was adopted by the board November 30 of that year directing the execution and delivery of two corporate notes, each for the sum of $1,000, and payable to the order of these gentlemen. In pursuance of this resolution the notes now under consideration were executed and delivered by the defendant Mitchell, as president of the corporation, and by Director Batcheller, as its secretary, on the same day.

All of this time the indebtedness of the corporation was largely in excess of the limit prescribed, and, of course, this was known to the directors. It is insisted by plaintiff's counsel that it was not shown at the trial that the original indebtedness for which the notes were given was that of the corporation, but, for the purposes of this case, we assume that it was. The notes became due on March 1, 1896. A month later the payees indorsed and transferred the same to one Fanning solely for the purpose of having him begin suit, and to secure a judgment thereon. April 18 a summons and complaint in said action were personally served upon Johnson, one of these defendants, a director of the corporation and a payee of the notes, and also upon the secretary, who, as before stated, had no personal interest in the obligations. The complaint was filed in the office of the clerk of court on the same date, and thereafter remained. May 29, 1896, judgment was entered in favor of Fanning against the corporation by default, and it became a first lien upon real property when final judgment was entered in the other case, setting aside the mortgage. December 30, 1896, an action was brought against the corporation under the provisions of G. S. 1894, c. 76, and this plaintiff was thereupon appointed receiver. The present action, to set aside the Fanning judgment, was instituted in August, 1900. The court below found for the defendants, and this appeal is from a judgment in their favor thereupon entered.

Testing this case by the rule laid down in *Taylor* v. *Mitchell*, *supra*, it would seem that the court below was in error. It was there held that the directors of an insolvent corporation, being its creditors, cannot take advantage "of their fiduciary relation, and deal directly

with themselves, to the injury of others in equal right. If they do, equity will set aside the transaction, at the suit of creditors of the corporation or their representatives, without reference to the question of any actual fraudulent intent upon the part of the directors; for the right of the creditors does not depend upon fraud in fact, but upon the violation of the fiduciary relation of the directors." The validity of such a transaction does not depend upon the presence of an actual fraudulent intent, but the pertinent and controlling inquiry is, has there been a violation of the duty which the directors owed to all creditors of the corporation, and a disregard of the rule that directors cannot take advantage of their relationship to the corporation, and secure to themselves an advantage or preference over other creditors?

Admitting that the transaction was legitimate up to the time the notes were transferred to Fanning and the action was brought, the corporation was then insolvent, and ought not to have transacted any other business—facts well known by the directors. Its indebtedness had for a long time exceeded its charter limit by about 50 per cent, and this the directors also well knew. That they transferred the notes to Fanning, a stranger to the transaction and to the corporation, may be only suggestive of a purpose, for some improper reason, to avoid being known in the action; but certain it is that these directors, trustees for all of the creditors, knew that, if their claim could become a first judgment, the lien of the same would be subject to the mortgage only, and would operate to destroy the value of the property to other creditors, in violation of their duty to preserve it for the equal benefit of all to whom the insolvent was indebted. It may be true that by executing and delivering the notes the then existing indebtedness of the company was not increased, but that does not dispose of the fact that by causing an action to be brought, and securing a judgment, which became a lien upon the corporate property, they were appropriating it for their own exclusive benefit, and to the direct injury of those who, upon every principle of justice, had equal rights with themselves. That the judgment through which they obtained this preference was not hastily obtained, but, on the contrary, that each step was taken with what may be called deliberate slowness, does not relieve the defendants of the charge that through this proceeding they have not acted in good faith, and that proper scrutiny of the transaction leads to the conclusion that their course was indefensible, unless we are to absolve directors of a corporation from the observance of good faith toward its creditors. These

directors have disregarded the governing principle in such cases, which is that the directors and manager of insolvent corporations are trustees of all the property, are bound to apply the same pro rata for the payments of debts, and cannot use it to exonerate themselves to the injury of other creditors.

Looking at the transaction in the most favorable light for defendants, the fact is apparent that, while occupying a relationship as to all creditors which demanded of them the utmost good faith, they caused this action to be brought, and countenanced and aided in the entry of a judgment which operated directly to secure the payment of their own debt in preference to debts of other creditors, when, as a matter of law, they were bound and should have taken steps to apply all of the assets of the corporation to the payment of all debts, pro rata and equally. Had they assumed to secure their own indebtedness by means of a mortgage executed and delivered upon the day judgment was entered, the transaction would have been set aside without the slightest hesitation, as was the mortgage involved in the former action, and for the same reasons. There is no real distinction between a transaction in which there is a direct conveyance of corporate property to creditors, and one by means of which the property may be appropriated to the payment of the same debt by means of legal proceedings. One is a friendly conveyance; the other is hostile, at least, in form; but this cannot be of importance.

The judgment is reversed, and the case remanded for proceedings in accordance with the views expressed above.

QUESTIONS

1. The D Company borrowed $5,000 from S, one of its stockholders, and gave him a mortgage on corporate property to secure the debt. Later on the corporation became insolvent. Creditors of the corporation bring proceedings to have the mortgage set aside. What decision?
2. In the foregoing case, the corporation was insolvent when it gave the mortgage to S. What decision?
3. The corporation borrowed $5,000 from D, one of its directors and gave him a mortgage to secure the debt. Later on the corporation became insolvent. Creditors of the corporation bring proceedings to have the mortgage set aside. What decision?
4. In the foregoing case, the corporation was insolvent when the mortgage was given. What decision?
5. In Question 2, it appears that S held a majority of the stock of the corporation and controlled the directors of the corporation. What decision?

HELLER *v.* THE NATIONAL MARINE BANK

89 Maryland Reports 602 (1899)

Appeal from a decree of the circuit court of Baltimore City (WICKES, J.) by which it was adjudged that the holders of the preferred stock of the Chesapeake Guano Co. have a lien upon the property of the corporation, including the moneys collected by the receivers, and are entitled to priority over creditors of the corporation whose debts were contracted subsequently to the time when said stock was issued. Affirmed.

MCSHERRY, C. J. The contention in this case is between the holders of what is called preferred stock and creditors of an insolvent corporation.

The stockholders of the Chesapeake Guano Co., a corporation formed under the general corporation laws of this state, voted some years ago to increase the company's capital by the issue of sixty thousand dollars of preferred stock. Without pausing at this point to examine whether the method pursued was the proper one or not, it suffices for the present to say that the authorized shares were all taken. Subsequently the company contracted debts due to unsecured creditors and thereafter became insolvent, and its property and assets were placed in the hands of receivers.

If this stock is preferred stock, pure and simple, the contention of the creditors is right. The law is perfectly well settled that as between creditors and ordinary preferred stockholders, the latter, as owners of the property of an insolvent corporation, are, upon a distribution of its assets, entitled to nothing until its creditors are first fully paid. There is a palpable difference between the relation of a stockholder and a creditor to the corporate property. Stock, whether preferred or common, is capital; and generally speaking, a certificate of stock merely evidences the amount which the holder has contributed to or ventured in the enterprise. Such a certificate, representing nothing more than the extent of his ownership in the capital, cannot well be treated as indicating that he is, by virtue of it alone, also to the same extent a creditor who may compete with other creditors in the distribution of the fund arising from a conversion of the corporation's assets into money. He cannot, if he is simply an ordinary preferred stockholder, in the nature of things, so far as third persons are concerned, be at one and the same time and by force of the same certificate, both part-owner of the

property and creditor of the company for that portion of its capital which stands in his name. His certificate, therefore, in such circumstances, merely measures the *quantum* of his ownership. As his chance of gain throws on the stockholder, as respects creditors, the entire risk of the loss of his contribution to the capital, it is a fixed characteristic of capital stock that no part of it can be withdrawn for the purpose of repaying the principal of the capital until the debts of the corporation are satisfied. *Warren* v. *King*, 108 U.S. 389; Cook on *Stock, etc.*, section 271; *Hamlin* v. *Toledo, St. L. & K. Railroad Co.*, 47 U.S. App. 422; S.C., 36 L.R.A. 826. Whether this characteristic may be modified by statute may be considered later on. To be strictly accurate, we ought to say there is a sense in which a shareholder is a creditor. In that sense every corporation includes its capital stock among its liabilities, but it is a liability which is postponed to every other liability. And as to the matured and unpaid guaranteed dividends due on preferred stock, the relation of creditor undoubtedly exists. *Baltimore & Ohio Railroad* v. *State*, 36 Md. 541.

But, after all, is this particular stock, technically speaking, ordinary preferred stock, and subject consequently to the legal incidents and characteristics of that species of property?

If you call it preferred stock, and it *is* what you call it, then the law is perfectly clear that it has no priority over the contesting creditors. If you call it preferred stock, and it is *not* preferred stock, then, obviously, it is not governed by the principles applicable to preferred stock, but by those relating to the thing that it really is. The mere naming of it does not make it that which it is named, if, in fact, it is something else. Its properties and qualities determine what it is. If the statute calls it what its properties and qualities show that it is not, surely it does not thereby become what it is misnamed, and cease to be what it essentially is. Calling stock preferred stock does not per se define the rights in such stock, but these depend on the statute or contract under which it is issued. *Elkins* v. *Cam. & A. R. Co.*, 36 N.J. Eq. 233. As said by the supreme court of Ohio:

> To call a thing a wrong name does not change its nature. A mortgage creditor, although denominated a preferred stockholder, is a mortgage creditor nevertheless, and interest is not changed into a dividend by calling it a dividend. Nothing is more common in the construction of statutes and contracts than for the court to correct such self-evident misnomers by supplying the proper words. To use the language of the court in *Corcoran* v.

Powers, 6 Ohio St. 19, "The question in such cases is, not what did the parties call it, but what do the facts and circumstances require the court to call it?" *Burt* v. *Rattle*, 31 Ohio St. 115.

Courts are not influenced by mere names. They look beyond these and give to the subject dealt with the character—the status—which its properties denote it possesses. The qualities and properties of a thing are its essentials, they define and mark what it is—the name is purely accidental—it is no part of the thing named. If, then, the thing which the statute contemplates, possesses the characteristics and qualities of preferred stock—and possesses none other—it is preferred stock; but if, on the other hand, it possesses characteristics and qualities that are entirely foreign to preferred stock as strictly defined, and that are descriptive of something else, then the thing is obviously either not ordinary preferred stock, or not preferred stock at all, even though it be called preferred stock, and have in addition to its own qualities some of the characteristics that do pertain to preferred stock. Precisely because preferred stock has no lien on the company's property and cannot be repaid in advance of general creditors, it is necessarily true that a security which is, by express and emphatic legislative enactment, entitled to just such a lien and just such priority, is not preferred stock technically speaking, though called by that name and though having many features incident to preferred stock. The whole ingenious and exceedingly able argument for the appellants proceeded upon the assumption that this is ordinary preferred stock, because called preferred stock, and because it possesses the incidents of such stock (but it ignored the fact that it has a quality which preferred stock has not), and the conclusion thence deduced was, that being that kind of stock it has no preferential lien. Now, the converse is exactly true. If the statute plainly gives a lien and a preference, then this so-called preferred stock is not ordinary preferred stock at all, no matter what it is called and no matter what incidents it may have in common with preferred stock, and, therefore, it has not that particular characteristic which, if it were ordinary preferred stock, would defer it to the claims of unsecured creditors. Brushing aside the name, let us see what are the essential qualities of this statutory creation.

The Act of 1868, chapter 471, section 219, authorized corporations to issue preferred stock. It was an alternative method of obtaining money. Any corporation which, under its charter, had authority to borrow money and issue bonds therefor, and secure the payment of

the bonds by mortgage, might, instead of resorting to that method, issue preferred stock. In issuing it the companies were empowered to execute an agreement guaranteeing to the purchasers of, or subscribers to, such preferred stock, a perpetual dividend of 6 per cent out of the profits of the corporation before any dividend could be paid to the holders of the common stock. The holders of such preferred stock were given all the incidents, rights, privileges, and immunities, and made subject to all the liabilities to which the holders of common stock were entitled or subject. This was strictly and technically ordinary preferred stock. It had no priority over creditors or over subsequent mortgages or incumbrances, and it had no lien on the franchises or the property of the corporation. It merely guaranteed a dividend of 6 per cent out of the profits—that is the net profits—and if there were no profits there would be no dividend. Its priority was simply a priority over the usual rights and interest of another, but subordinate, class of stockholders. That is the kind of preferred stock authorized by the Act of 1868, as a mere glance at its provisions—quoted in the beginning of this opinion, omitting the lines in italics—will demonstrate. In the language of the supreme court *Warren* v. *King*, *supra*, "it would be difficult to say that these statutory provisions allowed any preference in shares of capital stock, except a preference among classes of shares, or any preference of any class over creditors. There is nothing in the certificate that clothes them with a single attribute of a creditor." The stock authorized by the Act of 1868 was not only preferred stock, but it had every incident of stock, and none that was not. For twelve years the statute remained unchanged. Shares issued under it were, as we have said, essentially shares of capital with none of the qualities of an evidence of debt, and shareholders were simply owners of the capital, with none of the rights of creditors of the company. But in 1880 the statute was amended by the addition of the words in italics. By the provision requiring the agreement to be recorded no change was effected in the relation of the preferred to the common shareholder—the former was given no greater right over the latter than he had before the agreement was required to be recorded—and the relation of the preferred shareholder to the company's subsequent creditors was not disturbed unless the last clause, giving the shareholder a lien and declaring a preference in his favor, altered the nature of the preferred stock and made it something that it had not been under the Act of 1868. If the clause giving the shareholder a lien and a

priority did not create a new species of preferred stock, or a security differing radically from ordinary preferred stock, it is difficult, if not impossible to assign any reason for the adoption of the Act of 1880. The clause specifically declaring that "the said preferred stock shall be and constitute a lien on the franchises and property of such corporation, and have priority over any subsequently created mortgage or other incumbrance," essentially changed the whole nature of the thing antecedently described as preferred stock, and the statutory lien converted it into something wholly different. The statute says "said preferred stock"—not the guaranteed dividend thereon—shall be and constitute a lien on the property and franchises of the company. If you say the lien only extends to the dividend, then you say the stock shall not be a lien, though the legislature said it should be.

Preferred stock under the Act of 1868 had no lien whatever; this statutory preferred stock, under the Act of 1880—"The said preferred stock"—has a lien on franchises and on property. Preferred stock under the Act of 1868 had no priority over creditors; this statutory preferred stock under the Act of 1880 *has* priority over subsequent mortgages and incumbrances. The two are therefore intrinsically different, and the argument that gives to the latter no greater effect or wider range than the former possessed, simply because of the identity of the name applied to both, must totally ignore and in fact expunge the clause of the statute expressly creating the lien. If this statutory preferred stock has a lien, then it differs from ordinary preferred stock in that it has the lien. If, because it is called preferred stock, it has no lien, though the statute says it shall have, then the name controls the substance, and the lien expressly given is simultaneously taken away by the name conferred. Either the name or the substance must yield and certainly the latter cannot be made subordinate to the former.

Giving to the holder of what the Act of 1880 designates preferred stock a lien is not without precedent. It can be done and the ultimate question always is, has it been done? That it can be done a few citations will show. In Elliott on *Railroads*, section 85, the general rule is thus stated: "Unless a preference in payment of capital invested has been specially contracted for [*Re Bangor, etc., & Co.*, L.R. 20, Eq. 59; *Re Bridgewater Navigation Co.*, L.R. 39 Ch. Div. 1] or is given by statute [*McGregor* v. *Home Insurance Co.*, 33 N.J. Eq. 181], the holder of the preferred stock shares equally with the common shareholders in a distribution of assets upon dissolution. This results

from the rule that he is a stockholder and not a creditor." "But much," the same author proceeds to observe in section 86, "will necessarily depend upon the language used, and where the interest is guaranteed absolutely and the corporation also agrees to liquidate the principal at a specified time, or the like, so that the so-called stock is in reality an interest-bearing debenture, the relation created thereby will be that of debtor and creditor, and the holder will not be merely a stockholder as he would be if it were preferred or interest-bearing stock payable only out of the profits [*Burt* v. *Rattle*, 31 Ohio St. 116; *West Chester Railroad* v. *Jackson*, 77 Pa. St. 321; *Totten* v. *Tison*, 54 Ga. 139]. Its validity, therefore, would depend upon some other power than the power to issue preferred stock." And in Cook on *Stock, etc.*, section 271, it is said: "A mortgage to secure preferred stock and dividends thereon has been upheld in a few cases. In other cases that which was called preferred stock was nothing more than income bonds with a voting power." In the case of *Garrett et al.* v. *May et al.*, 19 Md. 191, the late Mr. Reverdy Johnson, in his argument, spoke of the "income bonds," which were there the subject of controversy, as equivalent to preferred stock. As the interest and principal of the bonds were payable out of income, it meant net income. "The holder," he said, "is thus made only a preferred stockholder," "Occasionally, however," remarks Mr. Cook, section 271, *Stock, etc.*, "a mortgage is given by the corporation to secure the payment of dividends on preferred stock and to give it a preference in payment over subsequent debts of the corporation upon insolvency or dissolution. It is difficult to see how such a mortgage could be legal except when it is issued under *express statutory authority*." In *West Chester Railroad* v. *Jackson*, *supra*, it is said by Judge Woodward, speaking for the court, "A corporation may issue new shares and give them a preference as a mode of borrowing money, where it has power to borrow on bond and mortgage, as preferred stock is only a form of mortgage." In *Skiddy* v. *Atlantic Railroad*, 3 Hughes, 355, it was held that where preferred stock had been issued, reciting that the stipulated interest was a lien on all the property of the corporation after the first mortgage, the lien would be upheld by the court as against subsequent mortgages and general creditors, though such lien had not been secured by any mortgage.

There ought, then, to be no doubt that this method of creating a lien in favor of a stockholder can be resorted to, if the legislature see fit to authorize it. That it has authorized it by the terms of the

Act of 1880, hereinbefore transcribed and put in italics, is, it seems to us, perfectly clear. The General Assembly has, in plain and unmistakable words, declared that this particular kind of stock—the "said preferred stock"—shall be and constitute a lien on the company's property. No language could be more explicit; and, most certainly, courts have no authority to reject or to disregard it. Stock issued under this Act is consequently a lien on the property of the company issuing it, and entitled to the preference which the statute gives it.

It is no answer to say that the giving of such a lien is nugatory by reason of a lien being inconsistent with the properties and qualities of stock; because it is quite obvious that after a lapse of twelve years the legislature, by adopting the Act of 1880, intended to do just what it did do, even though in doing it the nature of the thing dealt with was changed and a new and entirely different statutory preferred stock was created. That it had the power to do this cannot be disputed. There was neither physical nor legal impossibility in the way; and no principle of sound and enlightened public policy was invaded. The *substance* of the thing was changed, the *name* was retained.

From what has been said it results that, in our opinion, the so-called preferred stock is a lien on the company's franchises and property owned at the time the stock was issued.

QUESTIONS

1. What functions does preferred stock in a corporation perform? In terms of its functions, should it not be given a preference over the general creditors of the corporation in the distribution of the corporate assets?
2. Can the stockholders by the adoption of a by-law give a preference to holders of preferred stock over the general creditors of the corporation?
3. A statute provides that a corporation may issue a certain amount of preferred stock and that the preferred stock shall have a lien upon the corporate property and shall have priority over any subsequently created debt. Comment on the validity and purpose of such a statute.

CHAPTER VIII

DISSOLUTION OF THE BUSINESS UNIT

SOLOMON *v.* KIRKWOOD

55 Michigan Reports 256 (1884)

Cooley, C. J. The evidence given on the trial tends to show that on July 6, 1882, Hollander & Kirkwood entered into a written agreement for a partnership for one year from the first day of the next ensuing month, in the business of buying and selling jewelry, clocks, watches, etc., and in repairing clocks, watches, and jewelry, at Ishpeming, Michigan. Business was begun under this agreement, and continued until the latter part of October, 1882, when Kirkwood, becoming dissatisfied, locked up the goods and excluded Hollander altogether from the business. He also caused notice to be given to all persons with whom the firm had had dealings that the partnership was dissolved, and had the following inserted in the local column of the paper published at Ishpeming: "The copartnership heretofore existing between Mr. C. H. Kirkwood and one Hollander, as jewelers, has ceased to exist, Mr. Kirkwood having purchased the interest of the latter." This was not signed by anyone.

A few days later Hollander went to Chicago, and there, on November 9, 1882, he bought, in the name of Hollander & Kirkwood, of the plaintiffs, goods in their line amounting to $791.92, and gave to the plaintiffs therefor the promissory note now in suit. The note was made payable December 15, 1882, at a bank in Ishpeming. When the purchase was completed Hollander took away the goods in his satchel. The plaintiffs had before had no dealings with Hollander & Kirkwood, but they had heard there was such a firm, and were not aware of its dissolution. They claim to have made the sale in good faith, and in the belief that the firm was still in existence. On the other hand, Kirkwood claimed that Hollander and the plaintiffs had conspired together to defraud him by a pretended sale to the firm of goods which the plaintiffs knew Hollander intended to appropriate exclusively to himself; and he was allowed to prove declarations of Hollander which, if admissible, would tend strongly to prove such a conspiracy.

The questions principally contested on the trial were: first, whether the acts of Kirkwood amounted to a dissolution of the partnership; second, whether sufficient notice of dissolution was given; and third, whether there was any evidence to go to the jury of an understanding between Hollander and the plaintiffs to defraud Kirkwood. The trial judge, in submitting the case to the jury, instructed them that Kirkwood, notwithstanding the written agreement, had a right to withdraw from the partnership at any time, leaving matters between him and Hollander to be adjusted between them amicably or in the courts; and for the purposes of this case it made no difference whether Kirkwood was right or wrong in bringing the partnership to an end; if wrong, he might be liable to Hollander in damages for the breach of his contract. Also, that when partners are dissatisfied, or they cannot get along together, and one partner withdraws, the partnership is then at an end as to the public and parties with whom the partnership deals, and neither partner can make contracts in the future to bind the partnership, provided the retiring partner gives the proper notice. Also, that if they should find from the evidence that there was trouble between Hollander and Kirkwood prior to the sale of the goods and the giving of the note; that Kirkwood informed Hollander, in substance, that he would have no more dealings with him as a partner; that he took possession of all the goods and locked them up, and from that time they ceased to do business—then the partnership was dissolved. Further, that whether sufficient notice had been given of the dissolution was a question for the jury. Kirkwood was not bound to publish notice in any of the Chicago papers; he was only bound to give actual notice to such parties there as had dealt with the partnership. But Kirkwood was bound to use all fair means to publish as widely as possible the fact of a dissolution. Publication in a newspaper is one of the proper means of giving notice, but it is not absolutely essential; and on this branch of the case the question for the jury was whether Kirkwood gave such notice of the dissolution as under the circumstances was fair and reasonable. If he did, then he is not liable on the note; if he did not, he would still continue liable. .

The judge also submitted to the jury the question of fraud in the sale of the goods. The jury returned a verdict for the defendants.

1. We think the judge committed no error in his instructions respecting the dissolution of the partnership. The rule on this subject is thus stated in an early New York case. The right of a partner to

dissolve, it is said, "is a right inseparately incident to every partnership. There can be no such thing as an *indissoluble* partnership. Every partner has an indefeasible right to dissolve the partnership as to all future contracts by publishing his own volition to that effect; and after such publication the other members of the firm have no capacity to bind him by any contract. Even where partners covenant with each other that the partnership shall continue seven years, either partner may dissolve it the next day by proclaiming his determination for that purpose; the only consequence being, that he thereby subjects himself to a claim for damages for a breach of his covenant. The power given by one partner to another to make joint contracts for them both, is not only a revocable power, but a man can do no act to divest himself of the capacity to revoke it." *Skinner* v. *Dayton*, 19 Johns. 513, 538. To the same effect are *Mason* v. *Connell*, 1 Whart. 381 and *Slemmer's Appeal*, 58 Penn. St. 155. There may be cases in which equity would enjoin a dissolution for a time, when the circumstances are such as to make it especially injurious; but no question of equitable restraint arises here. When one partner becomes dissatisfied there is commonly no legal policy to be subserved by compelling a continuance of the relation, and the fact that a contract will be broken by the dissolution is no argument against the right to dissolve. Most contracts may be broken at pleasure, subject, however, to responsibility in damages. And that responsibility would exist in breaking a contract of partnership as in other cases.

2. The instruction respecting notice was also correct. No court can determine for all cases what shall be sufficient notice and what shall not be; the question must necessarily be one of fact. Publication of notice of dissolution in a local newspaper is common, but it is not the only method in which notice can be given. The purpose of the notice is to make notorious in the local community the fact that a dissolution has taken place; and publication of a notice may or may not be the most effectual means for that purpose. Very few persons in any community probably read all the advertisements published in the local papers; and matters of local importance which are advertised are quite as likely to come to them from other sources as from the published notices.

That publication in a newspaper is sufficient is not disputed by the defense, provided it appears on its face to be authoritative. *Ketcham* v. *Clark*, 6 Johns. 144; s.c. 5A Dec. 197; *Graves* v. *Merry*,

6 Cow. 701; s.c. 16 Am. Dec. 471; *National Bank* v. *Norton*, 1 Hill 578; *Nott* v. *Douming*, 6 La. 680; s.c. 26 Am. Dec. 491; *Watkinson* v. *Bank of Pennsylvania*, 4 Whart. 482; s.c. 34 Am. Dec. 521; *Rose* v. *Coffield*, 53 Md. 18; s.c. 36 Am. Rep. 389. But in this case it is said the notice did not appear to be authoritative; it appeared as a local editorial item, and such items are often baseless, and may in any particular case have no better foundation than rumor or even suspicion. They do not bear upon their face the verity which a notice signed by the party would import.

All this may be true without being conclusive. When the purpose is to put the fact of dissolution before the public, it certainly cannot be affirmed that the purpose is more likely to be accomplished by a formal advertisement than by an item in the local column of the newspaper. Many publishers, it is believed, have in their papers a local column in which items appear which seem on their face to be editorial; but which are really advertisements; and not only paid for, but paid at extra rates, for the reason that in that column they would be more likely to be seen and read than if published as advertisements in the ordinary way. When such is the case, a court could hardly hold as matter of law that the advertisement would be sufficient, but the notice in the local column not. To do so would be to make form more important than the purpose to be accomplished. One who derives knowledge of the fact from public notoriety is sufficiently notified. *Bernard* v. *Torrance*, 5 Gill. & J. 383; *Halliday* v. *McDougall*, 20 Wend. 81. And probably in many small communities a fact would sooner be made notorious by a notice in the local column of the county or village paper than in any other way. In a large city it might be otherwise. But all that can be required in any case is that such notice be given as is likely to make the fact generally known locally. *Vernon* v. *Manhattan Co.*, 22 Wend. 183, 193; *Lovejoy* v. *Spafford*, 93 U.S. 430. When that is done the party giving the notice has performed his duty, and anyone contemplating for the first time to open dealings with the partnership must at his peril ascertain the facts. This, in effect, was the instruction given.

3. But we think the judge erred in receiving evidence of Hollander's admissions or declarations tending to show fraudulent collusion between him and the plaintiffs. The declarations of a conspirator may be evidence against his associates after the conspiracy is made out; but to receive them as proof of the conspiracy would put every man at the mercy of rogues. We find in this case no evidence of the

conspiracy except in the statements of Hollander; and those having been erroneously received there was nothing on that branch of the case to submit to the jury.

For this error there must be a new trial.

QUESTIONS

1. It is said that a partnership relation may be terminated at any time by a mutual agreement of the partners. What is meant by this? How is such termination effected?
2. A and B enter into a partnership to engage in the milling business. Nothing is said in their contract as to the duration of the relation. A wishes to dissolve the relation, B wishes to continue it. How can A withdraw without incurring liability to B for damages?
3. A and B agree that the relation shall be continued for one year. A, before the end of the year, gives notice to B of his intention to withdraw from the firm and later withdraws. B sues A for damages. What decision?
4. A, before the expiration of the year, sells his interest in the business to C. B sues A for damages. What decision?
5. What is the effect of the following events on the continuance of the relation? (*a*) A dies. (*b*) A becomes insolvent. (*c*) A is declared a bankrupt.
6. What is the purpose of giving notice of dissolution of a firm? In what cases of dissolution must notice be given? To whom must notice be given? What kind of notice is necessary? Who should give the notice?

ASKEW *v.* SILMAN

95 Georgia Reports 678 (1894)

SIMMONS, C. J. Mrs. Silman sued Askew and others, alleged to be members of the firm of Austin & Co., upon a promissory note signed in the firm name and dated June 17, 1890. Askew pleaded not indebted; also, that he had not signed the note nor authorized any person to do so for him, and had never ratified the signing; and further, that he was not a member of the firm when the note was signed and was not bound by the contract, that the firm was dissolved January 11, 1888, and had ceased to do business from that date, which fact was known to the plaintiff when the note was executed. There was a verdict for the plaintiff against all the defendants sued; and Askew made a motion for a new trial, which was overruled, and he excepted.

The main question at issue on the trial of the case was whether there was such notice of the dissolution of the partnership as would

Dissolution ends liability only if third person has knowledge. Judicial action ends it as well.

relieve Askew from liability for the debt in question. It appeared from the evidence that the dissolution took place, as alleged in the plea, more than two years prior to the date of the note, and that the note was given by Austin, one of the copartners, without the knowledge or consent of Askew, for money borrowed by Austin in the name of the firm at the time the note was executed. Askew's withdrawal from the partnership was announced soon after the dissolution in a newspaper published in the town in which the plaintiff resided and the firm conducted its business, the announcement appearing at different times, in the form of news items written by the editor of the paper. The plaintiff was a subscriber to the newspaper when these notices appeared, but testified that she did not see them and that she had no notice or knowledge of the dissolution at any time prior to the execution of the note, but supposed when she took the note that Askew was still a member of the firm. She had been a customer of the firm, as a purchaser of goods, during Askew's connection with it, but was not a creditor before the date of the note. The court, in certain instructions to the jury which are complained of by the plaintiff in error, charged them, in effect, that if the plaintiff was a "customer" of the firm, she would be entitled to actual notice of the dissolution. We think the court erred in so charging. In order to relieve an ostensible partner from liability for debts contracted in the partnership name subsequently to his withdrawal from the firm, the dissolution must be made known "to creditors and to the world" (Code, section 1895), but it is not necessary that the notice should be actual or personal except to creditors. Although it is often said in textbooks and decisions that actual notice or knowledge of the dissolution must be brought home to former "customers" of the firm, this language has reference only to creditors. (See Bates on *Partnership*, section 613; 17 *Am. & Eng. Enc.*, 1124.) A customer in the sense in which the term was used in this case—that is to say, one whose dealings with the partnership have been confined to the purchase of its goods, is entitled only to such notice as should be given to "the world."

Judgment reversed.

QUESTIONS

1. This was an action by the P Bank on a note, purporting to be the note of Smith and Brown, trading partners, executed by Brown and discounted by the bank. Smith proved, in defense, that previous to the execution of the note the partnership relation between Brown and himself had been terminated by mutual assent; and that notice of such

termination had been published in a local newspaper. The bank proved that it had advanced money to the firm on several occasions and that it had never seen the notice in the paper. What decision?

2. P on several occasions sold goods to the firm of Smith and Brown but always for cash. P is suing the firm for goods sold to Brown on firm credit after the dissolution of the partnership. P proves that, although living in the same town, he had not seen the notice of dissolution. What decision?
3. B is suing Smith and Brown for money advanced to Brown on firm credit without knowledge of the dissolution of the firm. Smith proves that B, although knowing of the existence of the partnership, had never done business with it previous to its dissolution. What decision?
4. C is suing the firm for goods sold to Brown on firm credit without notice of the dissolution of the firm. Smith proves that C not only had never traded with the firm before but never knew, until after its dissolution, that such a firm had ever existed. What decision?

SHEA *v.* DONAHUE

15 Lea's Tennessee Reports 160 (1885)

Bill for partnership accounting between Shea and Donahue. They became partners under written agreement for one year "as merchants in making, buying, and selling all kinds of tinware, stoves, pumps, etc." "And to constitute a fund for the purpose Timothy Shea has paid in as stock one thousand dollars, which will constitute a common stock, to be used and employed between us in buying goods, wares, and merchandise. John Donahue being a practical workman and having considerable experience in the above-named business, it is agreed that he will give the business his entire personal attention and the benefit of his experience to place against the cash furnished by said Shea. We are to bear the expenses and losses jointly and share the profits equally. The capital stock is not to be withdrawn by either party until the end of the term, but to be employed as capital unless otherwise mutually agreed between us in writing." The business was in fact carried on for about three years. Upon the settlement, Donahue claimed to be entitled to one-half of the capital advanced by Shea. The chancellor decided against Donahue, and he appealed.

Cooper, J. The contention of the defendant is that by the terms of the agreement he was entitled at the end of one year to an equal share of the profits of the business, and to one-half of the capital advanced by his partner, and this, although it goes without saying he would retain all his practical experience which was to be placed

against the cash furnished by his partner. But the agreement is that the partners are only to "share the profits equally," not the profits and the capital. And the profits of any business are only what remains after deducting debts and expenses, and the capital paid in. Lindley on *Partnership*, pages 791, 806. The provision that the capital stock shall constitute a common stock to be used in buying the materials and wares of their trade, merely designates the mode in which it is agreed that the capital shall be invested. And the further provision that the capital stock shall not be withdrawn by either party until the end of the term was only intended to restrain the partners from drawing funds from the business so as to trench upon the capital while the partnership continued. There is nothing in the articles of agreement to take the case out of the ordinary one of a partnership in profit and loss upon unequal capitals.

Of course the articles of a partnership may expressly provide for an equal division of the assets, upon a dissolution, notwithstanding an unequal advance of capital by the respective partners. The same result may follow a continuous course of dealing upon a basis which implies such equal division. For if there is no evidence from which any different conclusion as to what was agreed can be drawn, the shares of all the partners will be adjudged equal, upon the favorite maxim of chancery that equality is equity. But, as Mr. Lindley tells us, the rule is when the partners have advanced unequal capitals, and have agreed to share profits and losses equally, without more, that each partner is entitled to his advance before division, and a deficiency in the capital must be treated like any other loss, and borne equally by the partners. Lindley on *Partnership*, page 807.

The only authorities adduced by the learned counsel of the defendant, in support of his contention in this case, are to the effect that property brought into the partnership business by the members of the firm, or bought with capital advanced, becomes partnership property, and may be disposed of as such by one of the partners under his general powers as a member of the firm. And so it does beyond all question, for the very object of contributing capital, either in property or money, is to secure a partnership stock for the purpose of carrying on the common business. But this fact has nothing to do with the settlement between the partners of their accounts at the end of the partnership. Mr. Lindley says:

By the capital of a partnership is meant the aggregate of the sums contributed by its members for the purpose of commencing or carrying

on the partnership business. The capital of a partnership is not therefore the same as its property; the capital is a sum fixed by the agreements of the partners, whilst the actual assets of the firm vary from day to day, and everything belonging to the firm and having any money value. Moreover, the capital of each partner is not necessarily the amount due to him from the firm; for not only may he owe the firm money, so that less than his capital is due to him, but the firm may owe him money in addition to his capital, e.g., for money loaned. The amount of each partner's capital ought therefore always to be accurately stated, in order to avoid disputes upon a final adjustment of accounts; and this is more important where the capitals of the partners are unequal, for if there is no evidence as to the amounts contributed by them, the shares of the whole assets will be treated as equal.—Lindley on *Partnership*, page 610 [1 Ewell's Lindley, 2d Am. Ed. 320].

The same author adds in another place:

When it is said that the shares of partners are *prima facie* equal, although their capitals are unequal, what is meant is that the losses of capital, like other losses, must be shared equally, but it is not meant that on a final settlement of accounts capitals contributed unequally are to be treated as an aggregate fund which ought to be divided between the partners in equal shares.—Lindley on *Partnership*, page 67.

On the contrary, in his chapter devoted to partnership accounts (2 Lindley, *Partnership*, 2d Am. Ed. 402), he expressly tells us that the assets of a partnership should be applied as follows:

1. In paying the debts and liabilities of the firm to non-partners.
2. In paying to each partner ratably what is due from the firm to him for advances as distinguished from capital.
3. In paying to each partner ratably what is due from the firm to him in respect of capital.
4. The ultimate residue, if any, will then be divisible as profit between the partners in equal shares, unless the contrary intent can be shown.

In accordance with these principles, the following decision has been made by the supreme court of New York in a case cited in a note to page 610 of Lindley on *Partnership:*

Where by the terms of the agreement the defendant furnished the capital stock, and the plaintiff contributed his skill and services, and the profits of the copartnership were to be equally divided, the plaintiff is not entitled to any part of the capital stock on a settlement of the affairs of the partnership. He has no interest in any part of the capital excepting so far as in the progress of the business the same may have been converted into profits.—*Conroy* v. *Campbell*, 13 Jones & Sp. 326.

The case, it will be noticed, is exactly in point. And to the same effect in principle are *Whitcomb* v. *Converse*, 119 Mass. 38, 20 Am. Rep. 311, *ante; Knight* v. *Ogden*, 2 Tenn. Ch. 473, and *Shepherd, Ex parte*, 3 Tenn. Ch. 189. No case has been found to the contrary.

Chancellor's decree affirmed.

QUESTIONS

1. The firm of Smith and Brown terminated by lapse of the time for which it was created. Brown is in possession of the records and property of the partnership. He refuses to account to Smith for his interest in the firm and is still carrying on the business in the firm name against the objections of Smith. What are the rights of Smith under the circumstances?
2. Smith contributed $12,500 to the capital of the firm and Brown contributed $7,500, but it was understood that Brown should devote his entire time and attention to the management of the business to offset the difference in their respective contributions to the capital of the partnership. At the time of the dissolution, the firm had assets aggregating $35,000. The firm owed B, $6,000; C, $3,500; and D, $3,000. The firm had made a loan of $2,500 to Brown which had not been repaid. Smith had advanced $5,000 to the business which had not been returned. How should the assets of the partnership be divided by a court upon dissolution?
3. Suppose that the assets of the partnership in the foregoing case had amounted to $45,000 at dissolution, how should the amount be divided?
4. A and B enter into a partnership with the understanding that A is to contribute $5,000 as capital, that B is to contribute his skill and services and that they are to share profits and losses equally. At the termination of the firm, its assets, after all liabilities have been discharged, amount to $6,500. How should this amount be divided between A and B?
5. In the foregoing case, the assets of the firm, after all liabilities have been discharged, amount to $4,000. How should the affairs of the business be adjusted as between A and B?

THE BOSTON GLASS MANUFACTORY *v.* LANGDON

24 Pickering's Massachusetts Reports 49 (1834)

Assumpsit on a promissory note given by the defendant to the plaintiffs. The defendant pleads in abatement, that at the time of the purchase of the writ there was not, and now is not, any such corporation established by law, called the Boston Glass Manufactory, as in and by the writ is supposed. The plaintiffs reply that there was and is such a corporation, and tender an issue, which is joined.

At the trial, before MORTON, J., the plaintiffs offered in evidence their act of incorporation, and showed their organization under it in 1811.

The records of the corporation were introduced by the plaintiffs, and were used and relied upon by both parties.

The defendant then introduced an indenture, dated May 27, 1827, assigning all the property of the corporation to certain persons, in trust to pay, pro rata, such creditors as should become parties to the indenture. This instrument contained covenants, that the assignees might use the name of the corporation in the collection of the debts, and in the disposition of the property assigned; that the corporation would not hinder or obstruct them in the performance of these functions; and that it would make any further conveyances and assurances which might become necessary, and perform any other and further acts which might be required to enable the assignees fully to execute their trust. No provision was made for a release to the corporation by the creditors, nor for paying over to the corporation the surplus, if any, of the property assigned. The defendant also referred to all the records subsequent to 1817, and contended that the assignment of the property of the corporation, and the omission to hold annual meetings, to choose directors, and to transact business, as appears by the records and books of the corporation, supported the issue on her part and entitled her to a verdict.

But the jury were instructed that the evidence was competent to prove the establishment and continuance of the corporation down to the present time.

The plaintiffs then claimed to have the damages assessed by the jury, if they found a verdict in their favor, and offered in evidence the note declared on. This was objected to by the defendant, because the note had been assigned. But the objection was overruled.

The jury found a verdict for the plaintiffs for the whole amount of the note and interest.

The defendant excepted to the decisions and instructions of the judge; and for the reasons above appearing, moved for a new trial.

MORTON, J. The principal question for our consideration is whether judgment shall be rendered on the verdict. The defendant's counsel contends that the evidence introduced will not support the verdict, but that the verdict is against the evidence and the law and should be set aside.

The legal establishment and due organization of the corporation were admitted; but it was contended that the facts disclosed showed a dissolution of it.

The elementary treatises on corporations describe four methods in which they may be dissolved. It is said that private corporations may lose their legal existence by the act of the legislature; by the death of all the members; by a forfeiture of their franchises; and by a surrender of their charters. 2 Kyd on *Corporations*, page 447; 1 Bl. *Comm.*, page 485; 2 Kent's *Comm.* (1st. ed.) 245; Angell & Ames on *Corporations*, page 501; *Oakes* v. *Hill*, 14 Pick. 442. No other mode of dissolution is anywhere mentioned or alluded to.

1. In England, where the parliament is said to be omnipotent and where in fact there is no constitutional restraint upon their action, but their own discretion and sense of right, corporations are supposed to hold their franchises at the will of the legislature. But if they possess the power to annul charters, it certainly has been rarely exercised by them. In this country, where the legislative power is carefully defined by explicit fundamental laws, by which it must be governed and beyond which it cannot go, it has become a question of some difficulty to determine the precise extent of their authority in relation to revocation of charters granted by them. But as it is not pretended that there has been any legislative repeal of the plaintiffs' charter, it will not be useful further to discuss this branch of the subject.

2. As all the original stockholders are not deceased, the corporation cannot be dissolved for the want of members to sustain and exercise the corporate powers. Besides, this mode of dissolution cannot apply to pecuniary or business corporations. The shares, being property, pass by assignment, bequest, or descent, and must ever remain the property of some persons, who of necessity must be members of the corporation as long as it may exist.

3. Although a corporation may forfeit its charter by an abuse or misuse of its powers and franchises, yet this can only take effect upon a judgment of a competent tribunal. 2 Kent's *Comm.* (1st ed.) page 249; *Corporation of Colchester* v. *Seaber*, 3 Burr. 1866; *Smith's Case*, 4 Mod. 53. Whatever neglect of duty or abuse of power the corporation may have been guilty of, it is perfectly clear that they have not lost their charter by forfeiture. Until a judicial decree to this effect be passed, they will continue their corporate existence. *The King* v. *Amery*, 2 T.R. 515.

4. Charters are in many respects compacts between the government and the corporators. And as the former cannot deprive the latter of their franchises in violation of the compact, so the latter cannot put an end to the compact without the consent of the former. It is equally obligatory on both parties. The surrender of a charter can only be made by some formal solemn act of the corporation; and will be of no avail until accepted by the government. There must be the same agreement of the parties to dissolve that there was to form the compact. It is the acceptance which gives efficacy to the surrender. The dissolution of a corporation, it is said, extinguishes all its debts. The power of dissolving itself by its own act, would be a dangerous power, and one which cannot be supposed to exist.

But there is nothing in this case which shows an intention of the corporators to surrender or forfeit their charter, nor anything which can be construed into a surrender of forfeiture.

The possession of property is not essential to the existence of a corporation. 2 Kent's *Comm.* (1st ed.), page 249. Its insolvency cannot, therefore, extinguish its legal existence. Nor can the assignment of all its property to pay its debts, or for any other purpose, have that effect. The instrument of assignment was not so intended, and cannot be so construed. All its provisions look to the continuance of the corporation. It contains covenants that the assignees may use the corporate name for the collection of the debts and the disposition of the property assigned; that the corporation will not hinder or obstruct them in the performance of these functions; that it will make any further conveyances and assurances which may become necessary, and will do and perform any other and further acts which may be required to enable the assignees fully to execute their trust. The instrument, which covenants for future acts, cannot be construed to take away all power of action.

The omission to choose directors clearly does not show a dissolution of the corporation. Although the proper officers may be necessary to enable the body to act, yet they are not essential to its vitality. Even the want of officers and the want of power to elect them would not be fatal to its existence. It has a potentiality which might, by proper authority, be called into action, without affecting the identity of the corporate body. *Colchester* v. *Seaber*, 3 Burr. 1870.

But here in fact was no lack of officers. Although no directors had been chosen for several years, yet, by the by-laws of the corpora-

tion, the directors, though chosen for one year, were to continue in office till others were chosen in their stead.

The damages were properly assessed by the jury. The defendant, having elected to try her case upon a plea in abatement, must submit to the legal consequences of that form of trial. Perhaps the court might have assessed the damages as in case of default. But most obviously the better course was to submit the subject to a jury. In doing this the defendant could not be allowed to go into the whole defense as upon the general issue. The rule adopted at the trial was the correct one.

Judgment according to verdict.

QUESTIONS

1. In what different ways may a corporation be dissolved?
2. S becomes the sole stockholder in the D Company. Does this effect a dissolution of the corporation?
3. S dies leaving no heirs. Does this cause a dissolution of the corporation?
4. The stockholders vote to dissolve their corporation. They distribute all the corporate assets among themselves. The directors resign. For ten years nothing is done in the name of the corporation. Is the corporation dissolved?
5. The D Company is chartered for a period of thirty years. Before the expiration of this time, the legislature passes an act repealing the charter of the corporation. The corporation contends that the law is unconstitutional because it violates that provision of the Federal Constitution which forbids a state to pass a law impairing the obligation of a contract. What decision?
6. Would your answer be the same in the foregoing case if the state in question had reserved the power to alter, repeal, or amend the charter of the corporation?

GOODWIN *v.* VON COTZHAUSEN

171 Wisconsin Reports 351 (1920)

This action was commenced in June, 1915, by the plaintiffs, H.W. Goodwin, as administrator of the estate of J. Arthur Davis, deceased, and F. B. Thomas, minority stockholders of the Milwaukee Lithographing Co., and Alfred von Cotzhausen, its president, general manager, and treasurer, and other officers, for said corporation to take charge of all its property and assets and to administer the same pending the determination of this suit, and for the restitution of

funds alleged to have been unlawfully abstracted therefrom by the said von Cotzhausen and other officers and directors of the corporation. The suit was brought by plaintiffs on their own behalf and on behalf of all other stockholders similarly situated. Their petitions were made by Edgar A. Goetz and Lillie A. Brosius, also minority stockholders, and they were made parties plaintiff, and they served separate supplemental complaints and a joint second supplemental complaint, demanding a winding up of all the business, property, and affairs of the Milwaukee Lithographing Co., a conversion thereof into cash, to be applied to the payment of debts and then distributed among the stockholders.

Upon motion made October 9, 1915, a receiver was appointed March 9, 1916, who took charge of the property, business, and affairs of the said Milwaukee Lithographing Co. and continued to administer the same until the entry of the judgment herein.

Owen, J. We have for consideration questions raised by the appeals of Alfred von Cotzhausen, Friedericke Bode, and H. W. Goodwin. Separate briefs were filed by Alfred von Cotzhausen and Friedericke Bode. Neither brief contains any assignment of error, nor is any finding of fact challenged in either brief. While it is to be gathered from the brief of the appellant Alfred von Cotzhausen that he is dissatisfied with the findings and with the judgment in general, there is no efficient challenge of any particular finding, nor is there any reference in the brief to any evidence in the record, or in the printed case prepared upon the appeal of H. W. Goodwin (which is the only case prepared by any of the appellants), to impeach the findings made by the referee and confirmed by the court. The record in the case is exceedingly voluminous, consisting of over 6,000 pages of typewritten matter and six large boxes of exhibits, and a general examination thereof for the purpose of verifying the findings of the referee cannot be undertaken. Under the circumstances, therefore, the findings of fact must be regarded as conclusive upon the appellants, Alfred von Cotzhausen and Friedericke Bode.

We may, however, consider the question of whether the judgment or interlocutory decree from which the appeal is taken is warranted by the findings. The appellants Bode and von Cotzhausen assail that part of the interlocutory decree which provides for a sale of the assets of the corporation, a distribution of the proceeds among the creditors and stockholders, and a winding up of its affairs. This is the vital question in the case as it is submitted.

It is contended that a court of equity has no power or jurisdiction, at the suit of a minority stockholder, in the absence of statutory authority, to appoint a receiver for a corporation and wind up its affairs. That such was the well-nigh universal rule until a comparatively recent date cannot be doubted. This rule had its origin at a time when corporations were created by special charters the grants of which conferred valuable and exclusive franchises upon their grantees, and it was considered that, as the franchises were granted by the state, they could be vacated or forfeited only in a proceeding by the state; that their lives depend upon the action of the state or the stockholders as a whole. The reason for this rule has entirely ceased in respect to the ordinary business corporation formed under general laws, the privileges conferred upon which are open to all who comply with statutory conditions, which conditions are simple and formal in character and may readily be complied with by any who desire to associate themselves for the prosecution of any business venture. The ordinary business corporations are not organized for the purpose of performing any public function and the state has no particular interest in them. It is only those who invest their money in them as stockholders or bondholders, and creditors thereof, who have a substantial interest in their proper management and business success. True, statutory regulations exist, but such regulations are enacted for the benefit and protection of those financially interested in the corporation and not for the protection of the state. The passing interest of the state in their continuance is well illustrated by the fact that a dissolution of the corporation automatically follows upon its failure to file certain reports in the office of the secretary of the state. Section 1774a, Stats. If the corporation were an institution in which the state had a special interest, its life would not be so summarily snuffed out for its mere failure to report the names and addresses of its officers to a public official.

The trend of modern decisions is in recognition of this growing distinction between the present and the original corporation, and there is now a respectable array of judicial authority for the proposition that where a corporation has been plundered by its officers, or they have so mismanaged its affairs as to bring it to the verge of bankruptcy, threatening the minority stockholders with loss of their investment, and it seems certain that the purposes for which the corporation was organized are no longer attainable, and there is no other adequate remedy, a court of equity, in the exercise of its inherent power, may

distribute its assets, and decree a dissolution thereof at the suit of a minority stockholder. *Miner* v. *Belle Isle Ice Co.*, 93 Mich. 97, 53 N.W. 218; *Red Bud Realty Co.* v. *South*, 96 Ark. 281, 131 S.W. 340; *Gibbs* v. *Morgan*, 9 Idaho, 100, 72 Pac. 733; *Riley* v. *Callahan M. Co.*, 28 Idaho, 525, 155 Pac. 665; *Thwing* v. *McDonald*, 134 Minn. 148, 158 N.W. 820; *Phinzy* v. *Anniston City Light Co.*, 195 Ala. 656, 71 South. 1018; *Exchange Bank* v. *Bailey*, 29 Okla. 246, 116 Pac. 812; *Metropolitan Fire Insurance Co.* v. *Middendorf*, 171 Ky. 771, 188 S.W. 790. In the above-cited cases the principle was either applied or recognized that where the officers and directors, or majority stockholders, exercising exclusive management and control over a corporation, have abused their power and proved recreant to their trust by fraudulently conducting the affairs of the company so as to appropriate to themselves the profits and property thereof, to the detriment of the minority stockholders, and the corporation is on the verge of bankruptcy, and the attainment of the purposes for which it was organized is no longer possible, and there is no other adequate remedy for the protection of the minority stockholders, a court of equity may, at the suit of a minority stockholder, appoint a receiver for the property of the corporation, decree a winding up of its affairs and a dissolution of the corporation itself.

The fading analogy between the present business corporation and the corporation as originally conceived, was recognized by this court in *Katz* v. *de Wolf*, 151 Wis. 337, 138 N.W. 1013, where it was said:

> The development of corporation law began with a strictness of analogy between municipal and stock corporations which is no longer fully observed. The change from the ancient mode of creating corporations by special act to permit organizations by public declaration or contractual undertakings acknowledged and filed in a public office, and the great multiplication of corporations thereunder, caused some further change. There is unquestionably a broad power of equity applicable wherever wrong is shown of such a nature as to arouse the equitable jurisdiction.

While the case did not present a situation calling for the exercise of the power, the language quoted forecast the opinion of this court with reference to its existence as well as its disposition to the exercise thereof. We agree with the Idaho court that

> The early doctrine that the affairs of a corporation could not be inquired into except by permission of the attorney general, and that courts of equity should not interfere with the power and authority of the directors of a corporation because that would result in its dissolution, has been modified

to meet existing conditions. A large part of the business of the world is done through corporations, and . . . . courts of equity should adapt their practice as far as possible to the existing state of society, and apply their jurisdiction to all those new cases which, from the progress daily making in the affairs of men, must continually arise, and should not, from too strict an adherence to the forms and rules established under very different circumstances, decline to administer justice and to enforce rights for which there is no other remedy.—*Gibbs* v. *Morgan, supra.*

The power, however, is one to be exercised with great caution. It is inherent in the nature of corporations that the affairs thereof are to be managed and directed as willed by the majority of the stockholders. Their decisions within the scope of legitimate discretion cannot be interfered with, and even though, in the opinion of the minority, the policies adopted by the majority are not for the best interests of the corporation, nevertheless they must accept such decisions and acquiesce therein. They cannot complain thereof unless they be prompted by fraud and bad faith, resulting in the spoliation of the minority stockholders and ruin to the corporation.

With this understanding of the power of the court in the premises, let us consider the record in this case with a view of determining whether the circumstances here disclosed present a proper situation for the exercise of this power.

The tabulation set forth in the statement of facts showing the course of business of the company from the year 1913 down to the appointment of the receiver March 9, 1916, shows that up to the year 1913, the year during which the defendant von Cotzhausen acceded to the presidency and general management thereof, the company did a thriving business, earned handsome profits, and paid gratifying dividends. In the year 1912 the company made profits of $45,465.50. In 1913 they dwindled to $11,617.64. In 1914 there were losses of $21,260.85. The losses during 1915, up to November 12, were $29,592.08, and from November 12, 1915, to March 9, 1916, there were further losses of $22,772.92. The amount of sales in 1912 was $310,697.23. In 1914, the first full year of management by von Cotzhausen, the sales were $164,508.45 a dropping off of nearly 50 per cent. The first months of 1915 the sales were only $25,783.23, and from July 12 to November 12 of the same year the amount of sales was $15,086.94. This shows an amazing decrease in the business and indicates that in but a short time the business would be practically nil. One marvels at the possibility of such a slump in

such a short time, but the record furnishes ample evidence of the reason thereof.

When von Cotzhausen assumed management of the company there was a well-organized sales force. There was a general sales agent on the Pacific Coast, one in New York, one in New Orleans, and two in Chicago. These sales agents were procuring business for the company. Good business judgment would plainly require a continuance of cordial relations between these sales agents and the company and a retention of their services. The evidence discloses, however, that von Cotzhausen immediately proceeded to get into a row with all these man and made it so disagreeable for them that they quit the service of the company. The services of one Frank W. Wentworth, of Chicago, appear to have been particularly valuable to the company. With reference to him the referee finds:

> That Frank W. Wentworth became connected with the Milwaukee Lithographing Co. in 1902, soon after the organization of said company, first as agent, and later as the agent, representative, and manager of Chicago of said company, and as such controlled the so-called Wrigley business; that he continued as such agent, representative, and manager until April 17, 1914, when said Wentworth severed his connection with said company; that during the year 1910 the said company shipped goods, the orders for which were obtained by Wentworth, in the amount of $103,171.30; in 1911, $186,121.35; in 1912, $151,470.81; in 1913, $132,531.63; or a total of $573,295.09; that the total business of said company during said four years aggregated $1,355,595.99; that after said April 17, 1914, the whole of said Wrigley business was withdrawn by said Wentworth from and lost to the said company; that as a result of such withdrawal and loss the successful operation of said company as a profitable business enterprise was greatly impaired.

Instead of maintaining satisfactory arrangements with the said Frank W. Wentworth, von Cotzhausen started an action against him to recover for the company $36,000 which he claimed Wentworth owed to it for overcharges, which the referee finds to have been unfounded, resulting in the loss of Wentworth's services and the business which he secured for the company.

This furnishes but a glimpse of the real character, attitude, and diplomacy of the said von Cotzhausen and is but a small part of the evidence which justifies the finding of the referee "that the defendant Alfred von Cotzhausen for many years past had and still has the reputation among the trade and business in which the Milwaukee

Lithographing Co. is engaged, as being unreasonable, unreliable, dishonest, and litigious, and as being a dangerous man to deal with."

There are unpaid judgments against the company amounting to $12,557.11, together with accrued interest, and it owes the Marshall & Ilsley Bank $17,500. While this would not be a forbidding indebtedness for a going concern of the size of the Milwaukee Lithographing Co., it is nevertheless a serious matter in view of the fact that the company was running at a loss for more than two years preceding the appointment of the receiver.

We cannot escape the conclusion that this company can be no longer operated under von Cotzhausen's domination and control except to its own ruin and the loss by the stockholders of their entire investment. The purposes for which the company was organized are no longer possible of accomplishment, and the only rational thing to do is to wind up its affairs and save the stockholders from further loss; from which it results that that feature of the interlocutory decree providing for a sale of the assets of the company and a winding up of its affairs should not be disturbed.

The appellant Goodwin complains because the court reduced the amount of general damages, found by the referee to have been $60,000 to $30,000. In *Huebner* v. *Huebner*, 163 Wis. 166, 157 N.W. 765, it was said: "The rule is well established in this court that past profits of an established business constitute a legitimate basis upon which to estimate the future profits of the same business conducted in the same manner, and that in a proper case such future profits may be recovered when the plaintiff has been prevented from making them by the wrongful conduct of the defendant."

We know of no reason why that principle is not applicable to the instant case. It is settled by the decisions of this court that where there is ample evidence to support a referee's findings of fact and no clear proponderance against them, the trial court is not justified in setting them aside. *Erickson* v. *McGeehan C. Co.*, 107 Wis. 49, 82 N.W. 694; *Ott* v. *Boring*, 139 Wis. 403, 121 N.W. 126; *Wojahn* v. *National Union Bank*, 144 Wis. 646, 129 N.W. 1068. The evidence to which our attention has been called clearly sustains the amount of damages as founded by the referee. If there is any evidence whatever against this finding it has not been pointed out to us, and our conclusion is that the trial court was not warranted in reducing the damages in this respect from $60,000, as found by the referee, to

$30,000. The interlocutory decree should therefore be modified by substituting $60,000, the amount found by the referee for general damages, for $30,000, the amount thereof as fixed and determined by the trial court.

By the interlocutory decree it is adjudged that the plaintiffs Brosius and Goetz are entitled to just and reasonable compensation for their attorneys' services and other expenses paid or incurred in this action and that the amount thereof should be determined by the court or referee after the sale of the property and effects of the company has been made and the affairs of the company liquidated before the final decree shall have been entered herein, to be paid out of the corporate assets of the Milwaukee Lithographing Co. Of this provision the plaintiff and appellant Goodwin complains, his position being, as we understand it, that, as he originally commenced the action, he is the only party who should be compensated out of the fund conserved for attorneys' services and other expenses. The plaintiffs Brosius and Goetz were made parties plaintiff by order of the court. Up until such time plaintiff Goodwin no doubt had control of the action, but after that time he had no more control thereof than plaintiffs Brosius and Goetz. Cook, *Corporation* (7th ed.) pages 2738–40. If the plaintiffs Brosius and Goetz rendered valuable services in the matter of conserving and saving the fund for the benefit of all the stockholders of the corporation, no reason is perceived why they should not be compensated as well as Goodwin. In this connection it should be observed that the amount of their reimbursement or compensation has not been fixed. That is left by the interlocutory decree to be determined by the court or referee after the sale of the property and effects of the company, and at the present time neither the plaintiff Goodwin nor any other party interested has anything of which to complain. However, in view of the fact that the question is presented, we think it proper to say that if the court shall determine that the plaintiffs Brosius and Goetz did render valuable services in the prosecution of the action and that their efforts contributed to the conservation of the fund, it is within the power of the court to provide for their reimbursement in such behalf. No further questions call for consideration.

By the court.—The interlocutory decree is modified by substituting sixty thousand ($60,000) dollars, for general damages as found by the referee, in lieu of thirty thousand ($30,000) dollars as determined by the trial court, and as so modified is affirmed.

QUESTIONS

1. Do you understand from the decision in the principal case that the court is dissolving the corporation in question? If so, under what power is the court acting in doing so? If not, what is the effect of the court's decree?
2. The D Company was incorporated with power to manufacture gas and light for the city of X. For several years the corporation has failed and refused to carry out its corporate undertaking. What action may be taken against it?
3. The corporation was incorporated with power to manufacture and sell lumber. For several years it has not exercised its corporate powers and privileges. What action may be taken against the corporation?
4. The D Company in excess of its powers entered into a combination with the B Company, a rival corporation. What action may be taken against it?

RICHARDS *v.* NORTHWESTERN COAL & MINING COMPANY

221 Missouri Reports 149 (1909)

This suit was begun in the circuit court of Macon County to determine the title to the coal underlying forty acres of land situated in said county. The judgment below was to the effect that neither plaintiff nor defendant had any estate, right, title, or interest in or to said coal. From that judgment both parties duly appealed.

WOODSON, J. It is the contention of counsel for plaintiff, that upon the termination of the bankruptcy proceedings in 1878 against the Central Coal & Mining Co., all of the property thereof not disposed of by the assignee reverted to the company; and that upon its dissolution by limitation, December 11, 1886, all of its undisposed-of real property by operation of law reverted to the grantor, John Richards, and that upon the death of the latter, the title thereto passed to his son, the plaintiff herein.

That contention is most earnestly denied by counsel for defendant; and they insist that under section 976, Revised Statutes 1899, which had been in force for many years prior to the organization of the Central Coal & Mining Co., the coal in question became vested in the officers of the company for the purpose of paying the debts and for the use of its stockholders. Said section 976 reads as follows:

Upon the dissolution of any corporation already created, or which may hereafter be created by the laws of this State, the president and directors or managers of the affairs of said corporation at the time of its dissolution,

by whatever name they may be known in law, shall be trustees of such corporation, with full powers to settle the affairs, collect the outstanding debts and divide the moneys and other property among the stockholders, after paying the debts due and owing by such corporation at the time of its dissolution, as far as such money and property will enable them; to sue for and recover such debts and property by the name of the trustees of such corporation, describing it by its corporate name, and may be sued by the same; and such trustees shall be jointly and severally responsible to the creditors and stockholders of such corporation to the extent of its property and effects that shall have come into their hands.

Plaintiff insists that said section has no application to the facts of this case, for the reason assigned—that at the time of the dissolution of the Central Coal & Mining Co. it had no president, director, or managers of its affairs, and that he or they could not, therefore, act as trustees for said corporation in the collection of its debts, or make distribution of its money and property among its stockholders.

There is no evidence contained in this record which tends to show that said corporation at the time of its dissolution had no such officers or stockholders. Counsel for plaintiff tries to supply that omission by insisting that the courts in the absence of evidence must presume that there were none such. We can indulge in no such presumption, for the reason that presumptions of fact never arise against the well-known, usual occurrences or conditions of things; such a corporation cannot be organized or exist without officers and stockholders and common knowledge and experience teach us that upon the dissolution of a business corporation, it invariably has a president or other chief officers, directors, and stockholders. That being true, the presumption must be to the contrary, that it did have such officers and stockholders.

But suppose we should indulge in that presumption, and concede for the sake of argument that said section 976 has no application, for the reason that there would be no one to collect and disburse the corporation's moneys and property, then would plaintiff be entitled to maintain this action? While the authorities are not uniform upon that question, yet the overwhelming weight thereof is against plaintiff's contention, that upon the dissolution of a corporation its real property reverts to the grantor.

This court, speaking by JUDGE NORTON, said:

After the statement of the doctrine in Angell & Ames on *Corporations*, that at common law, after the civil death of a corporation, all debts due to and from it are totally extinguished, the author adds, that "the

rule of the common law in relation to the effect of dissolution upon the property and debts of a corporation has in fact become obsolete and odious. Practically it has never been applied in England to insolvent or dissolved moneyed corporations, and in this country its unjust operation upon the rights of both creditors and stockholders of this class of corporation is almost invariably arrested by general or special statute [*McCoy* v. *Farmer*, 65 Mo. 244, l.c. 249].

Thompson on *Corporations* states the rule as follows:

We have had occasion to note, in passing, the principle of the ancient common law that, upon dissolution of a corporation, its real property, acquired by gift or grant for corporate use, reverts to the donor or grantor, or his heirs; and we have also noticed the pointed denial by Chancellor Kent that such was ever the law of England as regards moneyed corporations. . . . . Notwithstanding this language, the author does not believe that a case can be found, decided in any of the English courts within the last hundred years, where it was held that land which had been purchased by an incorporated joint-stock business company, for a consideration, reverted, on the dissolution of the corporation, to the grantor or his heirs; or, where the personal property of such a corporation, upon the event of its dissolution, was held to escheat to the crown. . . . . The modern rule then is, that, upon dissolution, the title to real property does not revert to the original grantors, or their heirs, and the personal property does not escheat to the State, but that both species of property vest in a receiver or other trustee; and that all the property, real and personal, of the corporation, is to be administered by him for the benefit of creditors and stockholders [5 Thompson on *Corporations*, sections 6745, 6746].

The doctrine of reverter is also denied in the state of New York. JUDGE RAPALLO, delivering the opinion of the New York Court of Appeals, said:

In so far as the plaintiff's right to recover in this action is sought to be sustained on the ground that at common law real estate held by a corporation at the time of its dissolution reverts to the grantor, it cannot be supported for two reasons: First, because the plank-road company has not been dissolved; and, secondly, because the rule of law invoked by the plaintiff does not prevail in this State in respect to stock corporations. Under the provisions of 1 R.L. 248, and 1 R.S. 600, sections 9 and 10, upon the dissolution of a corporation, the directors or managers at that time become trustees of its property (unless some other custodian is appointed) for the purpose of paying the debts of the corporation and dividing its property among its stockholders; and these provisions apply as well to the real as to the personal property of corporations. Consequently, where lands are conveyed absolutely to a corporation having stockholders, no

reversion or possibility of a reverter remains in the grantor. The conveyances to the plank-road company in this case appear to have been absolute conveyances—no condition or limitation of the estate seems to have been contained in them, and they, therefore, passed the whole estate of the grantor [*Heath* v. *Barmore*, 50 N.Y. 302 l.c. 305].

And 2 Cook on *Corporations* (6 ed.) section 641, denies the doctrine of reverter in the following language:

It was formerly believed to be the common law that upon the dissolution of a corporation all its assets belonged to the State, and all its debts were cancelled, and that the creditors were not entitled to anything from the assets. This remarkable theory has been stated and restated in textbooks and decisions of the courts for over one hundred years. It is found in Blackstone's *Commentaries* and in the old works of Kyd on *Corporations* and Grant on *Corporations*. The courts, however, while upholding the rule theoretically, have quite uniformly refused to apply such a doctrine, and have invented various theories, fictions and arguments for avoiding this supposed doctrine of the common law. Finally, in 1899, an English court denied that the common law never countenanced such confiscation, and showed that in the seventeenth and eighteenth centuries many corporations were dissolved, and that in not a single case was any such doctrine applied. It again may be said that, although the common law has its reproaches, this is not one of them. The American courts have always refused to follow the supposed common-law rule on this subject.

The Supreme Court of Wisconsin said:

The claim is made . . . . that under the common-law rule debts due it or owing by it are extinguished, and that its personal property then undisposed of escheats to the State, and its real estate reverts to its grantors or donors. If these propositions are well founded, the legal consequences are certainly weighty and far-reaching, and there should be no uncertainty in their application for the ascertainment of private property rights, and of those of the State within their operation. True, there are cases declaring that the dissolution of a corporation is followed by such results, but the trend of modern adjudications on the subject disavows that such were the doctrines of the common law as regards moneyed or commercial corporations. The result of the adjudications seems correctly and well stated by Chancellor Kent. He observes: "The rule of the common law has in fact become obsolete and odious. It never has been applied to insolvent or dissolved moneyed corporations in England. The sound doctrine now is, as shown by statutes and judicial decisions, that the capital and debts of banking and other moneyed corporations constitute a trust fund and pledge for the payment of creditors and stockholders, and a court of equity will lay hold of the fund, and see that it be duly collected and applied" [Kent, 307,

note]. The reason usually assigned for rejecting the old rule and holding it inapplicable is that the rule had its origin in a time when corporations dealt almost exclusively with municipal, ecclesiastical, and eleemosynary affairs, and when the modern business corporation was unknown, and that the growth of these moneyed corporations necessitated the application of principles which would protect the private property interests of persons dealing with them under the changed conditions. To this end, the rights and interests in and to the property of business corporations are, in their essentials and nature, considered to be like those pertaining to partnership organizations; and when such corporation dissolves, and thereby loses legal capacity to preserve its estate, a court of equity will, if necessary, lay hold of its assets to compel a final liquidation of its affairs, and a distribution of the capital among the stockholders as in partnership associations [*Lindemann* v. *Rusk*, 125 Wis. l.c. 229].

We, therefore, hold that the so-called common-law rule of reverter is not in force in this state, and that even in the absence of said section 976 a reverter to the corporation would not have taken place.

We are, therefore, of the opinion that the finding and judgment of the circuit court as to plaintiff was proper.

QUESTIONS

1. When a corporation is dissolved in any manner, is there any necessity of giving notice of the dissolution to anyone? If not, why not?
2. Upon dissolution of a corporation what becomes of its real property? its personal property?
3. The D Company is dissolved, owing $5,000 to P. What are the rights of P with respect to this claim?
4. The P Company is dissolved, having a claim against D for $5,000. What becomes of the claim?
5. Who is charged with the duty of winding up the affairs of a corporation after its dissolution?

TABLE OF CASES

Adair v. *United States*, 154
Alabama Life Insurance Co. v. *Johnston*, 102
Amicable Society v. *Boland*, 94
Andrews' Heirs v. *Brown's Heirs*, 299
Angier v. *Western Assurance Co.*, 113
Askew v. *Silman*, 623

Bank of Holly Springs v. *Pinson*, 506
Benwell v. *City of Newark*, 402
Bergeron v. *Hobbs*, 358
Boston Glass Manufactory v. *Langdon*, 628
Boyer v. *Western Union Telegraph Co.*, 260
Bracken v. *Kennedy*, 305
Brintons v. *Turvey*, 209
Brown v. *Winnisimmet Co.*, 441
Bucksport & Bangor Railroad Co. v. *Inhabitants of Brewer*, 394
Burral v. *The Bushwick Railroad Co.*, 377
Burt v. *Lathrop*, 288
Button v. *Hoffman*, 301

Cannon v. *Phoenix Insurance Co.*, 89
Castellain v. *Preston*, 137
Central Railroad Co. v. *Collins*, 473
Challis v. *London & Southwestern Railway Co.*, 214
Charles River Bridge v. *Warren Bridge*, 432
Chicago & Northwestern Railway v. *James*, 542
Chicago, Pekin & Southwestern Railroad Co. v. *Marseilles*, 453
Clover, Clayton & Co. v. *Hughes*, 206
Coleman v. *Hagey*, 438
Collings v. *Allen*, 390
Commonwealth Insurance Co. v. *Sennett*, 129
Continental Insurance Co. v. *Munns*, 68
Crane v. *Crane & Co.*, 10
Creed v. *Sun Fire Office of London*, 36
Cronin v. *Vermont Life Insurance Co.*, 43

Danbury Hatters' Case, 264
Decatur Mineral Land Co. v. *Palm*, 493
Dennison v. *Thomaston Mutual Insurance Co.*, 60
Densmore Oil Co. v. *Densmore*, 330
Dolliver v. *St. Joseph Fire Insurance Co.*, 116
Dudley v. *Kentucky High School*, 471
Dunphy v. *Travelers' Newspaper Association*, 490
Duplex Printing Co. v. *Deering*, 268

East Birmingham Land Co. v. *Dennis*, 411
Edelstein v. *Schuler & Co.*, 412
Einstein v. *Raritan Woolen Mills*, 372
Ermentrout v. *Girard Fire Insurance Co.*, 92
Everett Waddey Co. v. *Richmond Typographical Union*, 232

Farmers' & Merchants' Bank of Lineville v. *Wasson*, 403
Farmers' Loan & Trust Co. v. *New York & Northern Railway Co.*, 479
Farwell v. *Boston & Worcester Railroad Corporation*, 165
Faust v. *American Fire Insurance Co.*, 111
Fidelity Trust Co. v. *Lehigh Valley Railroad Co.*, 427
First National Bank of Fort Scott v. *Drake*, 540
Fletcher v. *Pullen*, 363
Foley v. *Manufacturers' Fire Insurance Co.*, 30
Foster v. *White*, 520
Fowler v. *Aetna Insurance Co.*, 105
Franklin Bank v. *Commercial Bank*, 456

Gibb v. *Philadelphia Fire Insurance Co.*, 118
Gibson v. *Erie Railway Co.*, 164
Gilchrist v. *Collopy*, 516
Glamorgan Coal Co. v. *South Wales Miners' Federation*, 250
Goodwin v. *von Cotzhausen*, 632

Gress v. *Knight*, 605
Griffith v. *Cole Bros.*, 213
Grosvenor v. *Atlantic Fire Insurance Co.*, 76
Guarantee Trust & Safe Deposit Co. v. *E. C. Drew Investment Co.*, 582

Hall's Safe Co. v. *Herring-Hall-Marvin Safe Co.*, 318
Hamsmith v. *Espy*, 589
Haug v. *Haug*, 337
Heller v. *National Marine Bank*, 612
Hendren v. *Wing*, 293
Hibblewhite v. *McMorine*, 13
Hicks v. *British America Assurance Co.*, 22
Holden v. *Hardy*, 159
Hospes v. *Northwestern Manufacturing & Car Co.*, 597
Hudson Real Estate Co. v. *Tower*, 386
Hun v. *Cary*, 553
Hunter v. *Roberts, Throp & Co.*, 422
Hutchinson v. *Green*, 536

Johnson v. *Berkshire Fire Insurance Co.*, 86
Johnston v. *Dutton*, 467
Johnston v. *Fargo*, 150
Jones v. *Van Winkle Gin & Machine Works*, 236

Katz v. *Brewington*, 503
Kemp v. *Division No. 241*, 223
Kimball v. *Aetna Insurance Co.*, 65
Kirkpatrick & Lyons v. *Bonsall*, 15

Lamson v. *American Axe & Tool Co.*, 177
Lawlor v. *Loewe*, 264
Leffler v. *Rice*, 529
Lemon v. *Phoenix Mutual Life Insurance Co.*, 80
Liverpool Insurance Co. v. *Massachusetts*, 285
Long v. *Georgia Pacific Railway Co.*, 458
Lumley v. *Gye*, 217

McArthur v. *Times Printing Co.*, 327
Major v. *Hawkes*, 534
Mallory v. *Hanaur Oil Works*, 465
Mann v. *O'Sullivan*, 172
Mason v. *Eldred*, 308
Master Stevedores' Association v. *Walsh*, 217
Miller v. *Ewer*, 512
Mitchell v. *Reed*, 567
Monument National Bank v. *Globe Works*, 450
Morton Gravel Road Co. v. *Wysong*, 505
Mutual Life Insurance Co. of New York v. *Allen*, 70

New York Central Railroad Co. v. *White*, 190
Nicoll v. *New York & Erie Railroad Co.*, 436
Nims v. *Mount Hermon Boys' School*, 575
Nisbet v. *Rayne & Burn*, 208
Norfolk & Western Railroad Co. v. *Hoover*, 186
Northern Trust Co. v. *Columbia Straw-Paper Co.*, 380
Northside Street Railway Co. v. *Worthington*, 445

Oshkosh Gas Light Co. v. *Germania Fire Insurance Co.*, 133

Paducah & Memphis Railroad Co. v. *Parks*, 397
Parkinson Co. v. *Building Trades Council*, 254
Parsons v. *Joseph*, 499
Patterson v. *Mutual Life Insurance Co.*, 96
Pennsylvania Mutual Life Insurance Co. v. *Mechanics Savings Bank & Trust Co.*, 52
People v. *Ford*, 344
Phoenix Fire Insurance Co. v. *Erie Transportation Co.*, 135
Plant v. *Macon Oil & Ice Co.*, 475
Pooley v. *Whitmore*, 524
Pratt v. *Bacon*, 284
Proudfoot v. *Montefiore*, 57
Pullis v. *Robison*, 83

Richards v. *Northwestern Coal & Mining Co.*, 640
Richmond & Danville Railroad Co. v. *Jones*, 183
Rittler v. *Smith*, 46
Robinson Bank v. *Miller*, 369
Rodgers v. *Meranda*, 592

Rothchild v. *Memphis & Charleston Railroad Co.*, 549
Ruse v. *Mutual Benefit Life Insurance Co.*, 26

Sanborn v. *Royce*, 590
Saunders v. *Eastern Hydraulic Brick Co.*, 181
Schwab v. *Potter Co.*, 486
Shea v. *Donahue*, 625
Smith v. *Hurd*, 545
Smith v. *Mechanics' Fire Insurance Co.*, 108
Smith v. *San Francisco & Northern Pacific Railway Co.*, 415
Society Perun v. *City of Cleveland*, 350
Sodiker v. *Applegate*, 340
Solomon v. *Kirkwood*, 619
Solt v. *Williamsport Radiator Co.*, 178
Spangler v. *Indiana & Illinois Central Railway Co.*, 382
State v. *Lehigh Valley Railroad Co.*, 578

Tapley v. *Butterfield*, 531
Taylor v. *Fanning*, 608
Taylor v. *Howard*, 18
Terlecki v. *Strauss*, 210
Thompson v. *Blaisdell*, 412
Thrasher v. *Pike County Railroad Co.*, 388

United States v. *Milwaukee Refrigerator Transit Co.*, 321

Viele v. *Germania Insurance Co.*, 121

Wainer v. *Milford Mutual Fire Insurance Co.*, 33
Wainwright v. *P. H. & F. M. Roots Co.*, 562
Warren v. *Davenport Fire Insurance Co.*, 38
West Nashville Planing-Mill Co. v. *Nashville Savings Bank*, 407
White v. *Eiseman*, 289
Whitehead v. *Reader*, 211
Whitney Arms Co. v. *Barlow*, 460
Willcutt & Sons Co. v. *Driscoll*, 240
Willmott v. *London Road Car Co.*, 314
Wood v. *American Fire Insurance Co.*, 297
Woodward v. *McAdam*, 295

Yates v. *South Birby Collieries*, 204

INDEX

[Figures refer to pages. C and CC refer to "case or cases beginning on page or pages," as CC 423, 425 means cases beginning on pages 423 and 425.]

Accident, CC 206, 208, 209, 210, 211, 213, 214
Assumption of risk by servant, doctrine of, CC 164, 165, 177, 181, 186, 197, top

Blacklisting of employees, C 260
Boycott, CC 254, 264
  Liability of members of union for, C 264
  Primary and secondary, discussed, C 268
Business relations, interference with, C 217 (1)

Clayton Act:
  Effect of, on injunction, C 268
  Effect of, on labor combinations, C 268
Collective bargaining, CC 217 (2), 223
Combination of laborers:
  Lawful objects, CC 217 (2), 223
  Means available to enforce, CC 217 (2), 236, 240
  To maintain price of labor, C 217 (2)
Competitive labor practices, law of, governing, 217 ff.
Concealment, *see* Insurance contracts
Conditions, *see* Insurance contracts
Conspiracy discussed, CC 217 (2), 260
Contract of employment, CC 150, 154, 159
Contract to sell, distinguished from gambling contract, CC 13, 15, 18
Contributory negligence, doctrine of, CC 177, 178
Corporations:
  Abuse of power by, as distinguished from doing unauthorized act by, C 450
  Acts of, as distinguished from act of members, CC 301, 318, 321
    Invalid when, CC 512, 556
  Agreement of shareholders to vote as unit, C 145
  As a person, CC 301, 314, 318, 321
  Bondholders' rights against, C 380
  Bonds of, transfer of, CC 402, 412 (1)
  Bonus stock, liability of holder of, to creditors of corporation, C 597
Corporations, *cont.*:
  By-laws may be made by whom, CC 505, 506
  Common law powers of, CC 436, 438, 441, 445, 450, 453, 456
  Conditional subscription to stock, CC 386, 390, 394, 397
  Control of, by whom, CC 505, 506
  Courts open to minority shareholders of, when, CC 490, 493, 499
  Created how, CC 350, 358
  Creditors of, position of, CC 597, 605, 612
    When also directors, C 608
  Creditors' rights against shareholders of, C 597
  De jure and *de facto*, CC 344, 350, 358
  Directors:
    Acts of, contrary to wishes of majority of shareholders, C 536
      Must be done how, C 540
    As creditors of, C 608
    Duties of, CC 422, 479, 493, 536, 540, 545, 553, 562
    Elected how, C 516
    Hold office by virtue of what, C 516
    Meeting of:
      Held where, C 512
      Necessity for, C 540
    Powers of, C 536
      As to management, CC 553, 562
      To deal with themselves, C 562
    Relation to corporation, CC 422, 553, 562
    Relation to creditors of corporation, C 608
    Relation to shareholders, CC 422, 545
    Validity of acts of persons acting as, C 516
  Dissolution:
    Disposition of property upon, C 640
    Majority's right to effect, C 632
    Occasions for, C 628
    Rights of members upon, CC 612, 632
    Rights of minority upon, C 632
    What constitutes, C 628
  Distinguished from owners of stock, C 301

Corporations, *cont.:*
Dividends, CC 422, 427; *see* Corporations, Shareholders
Illegal, C 490
Doctrine of implied powers, CC 432, 441, 445, 450, 453
Features of, C 285
Formed how, CC 285, 344, 344 note
Implied powers, how found, CC 432, 436, 438, 441, 445, 450, 453
Legal status of, CC 301, 314, 318, 321
Liability of, for contracts made by promoters, CC 327, 330
Liability of stockholders to, C 380
Lien of, against shares, C 506
Majority powers, CC 471, 479, 632
Of shareholders in management, C 412 (2)
To dissolve, C 632
Members' rights against directors, C 545
Minority shareholders' rights and powers, CC 372, 471, 473, 475, 486, 490, 493, 499, 632
Nature of, CC 284, 285
Necessity for compliance with statutes in organization of, CC 344, 350, 358
Powers of, effect of exceeding, CC 458, 460, 465
General, C 486
How determined, CC 432, 436, 438, 441, 445, 450, 453
To dispose of property, C 475
To hold stock in another corporation, CC 456, 473
To make contracts of partnership, 465 note
Powers of officers of, C 542
Preferred shareholders of, relation of, to creditors, C 612
Preferred stock in, dividends on, C 427
Promise to subscribe to stock of, C 386, 388
Promoters' relation to, CC 327, 330
Property of, belongs to whom on dissolution, C 640
Distribution of, on dissolution, C 640
Title to, in whom, C 549
Proxy vote in shareholders' meeting, CC 412 (2), 415
Quorum of shareholders' meeting, C 516
Receivers, discussed, C 597
Refusal by, to transfer on books, transferred stock, C 456
Reorganization of, C 486
Responsibility for crimes, C 578

Corporations, *cont.:*
Responsibility for torts, C 375
Rights of, against shareholders, C 506
Rights of members in management, C 520
Rights of minority, C 632; *see* Minority shareholders, *supra*
Rights of, to dispose of property, C 438, 445
Securities of, kinds of, CC 402, 412 (1)
Share of stock in, what is, C 377
Shareholder estopped to attack acts of, when, C 499
Shareholders:
Liability to creditors, for unpaid stock, C 597
Relation to corporation, C 605
Relation to creditors of corporation, C 605
Relation to each other, C 605
Relation to property of, C 549
Rights against corporation, CC 473, 475
Rights on dissolution, CC 632, 640
Rights to dividends, CC 422, 427
Shares of stock, transferred how, C 403
Stock, fraudulent, C 499
Stock, may be dealt with, how, by, C 377
May be increased how and when, C 372
Purchased by corporation in itself, C 453
Transfer of, C 411
Effective when, C 403
Subscribers, liability of, CC 382, 386, 388, 390, 394, 397
Right to rescind contract of subscription, C 605
Subscription on condition, CC 386, 390, 394, 397
Subscription on special terms, C 397
Transfer of bonds of, CC 402, 412 (1)
Transfer of shares in, CC 377, 403, 411, 506
Completed when, C 412 (2)
Transferee of stock not fully paid up, position of, and liability of, for remainder, C 407
Trust fund doctrine, C 597
Ultra vires:
Acts, CC 458, 486
Contracts, CC 458, 460, 465
Unpaid stock, shareholders' liability to corporation creditors for amount of, C 597
Who has title to property of, C 301
Who may attack existence of, C 350

Corporations, *cont.*:
Who may vote in shareholders' meeting, C 412 (2)

Damnum absque injuria, 225
Discharge of employee for joining union, C 154
Due process of law, 147, C 190

Employer, duty of, to other employers' C 217 (1)
Duty of, to employees:
To provide safe place for work, CC 177, 181
To use ordinary care, C 150
To use ordinary care in selection of fellow-servants, CC 165, 171, 186
To provide reasonably safe equipment, C 182
Liability of, for injury done to third person by servant, 186
Liability of, for injury to servant, CC 150 and 164–214
As affected by legislation, 190–214
Employment, interference with contracts of, C 217 (1)
Relation of, *see* Master and Servant, *infra*
Some problems of, as affected by law, 145–49

Fellow-servant, defined, C 172
Fellow-servant rule, CC 165, 172, 186
Financing of business unit, *see* Table of Contents
Form of business unit, *see* Table of Contents:
Questions arising in connection with, 281 ff.
Fraud, *see* Insurance, contracts of
Freedom of contract, 146, 147, C 217 (1)
Limited how, CC 150, 154, 159

Gambling contracts, not enforcible, why, 5
What constitutes, 6, CC 15, 18
Hours of labor laws, constitutionality of, C 159

Inducement of breach of contract, C 250
Injunction:
Affected by Clayton Act, C 268
Protects what, 148, 149
Use of, in labor disputes, CC 223, 232, 236, 240, 250, 254, 260, 266
Injury, "arising out of and in the course of employment," CC 204, 206, 208, 209, 210, 211, 213, 214
Insurable interest, *see* Insurance, contracts of
Insurance agents, general powers of, C 121

Insurance, contracts of:
Against fire, covers what risks, CC 86, 89, 92
Against loss of life, covers what risks, CC 94, 96
Amount of recovery under, CC 129, 133
In life insurance, C 46
In property insurance, C 30
Assignment of fire policies, CC 68
Assignment of life policies, C 70
Beneficiaries of, CC 76, 80, 83
Change of interest, effect of, on, C 118
Concealment in, CC 52, 57
Conditions in, CC 111, 113, 118, 121, 116
As to ownership, interpreted, CC 116, 118
Interpreted how, C 111
May be waived, how, C 121
Not breached by negligence of insured, C 113
Of notice of loss, effect of breach of, C 92
Waiver of, C 121
Contract of indemnity, CC 129, 135, 137
Creditors' rights, as against beneficiary of life, C 83
Death by legal execution, effect of, on life policy, C 94
Devices for shifting risks, 9
Direct results of fire covered by, CC 89, 92
Effect of payment under, when no loss, C 137
Formation of, C 22
Fraud, effect of, on, C 96
Insurable interest gives right of recovery for how much:
In life insurance, C 46
In property insurance, C 30
Necessary to validity of policy, CC 26, 30, 33, 36, 38, 43, 46, 76
What is:
In fire insurance, CC 30, 33, 36, 38
In life insurance, CC 43, 46
Insurer's right to subrogation after payment under, CC 135, 137
Misrepresentation in, CC 60, 65
Negligence of insured, effect of, on fire policies, CC 86, 113
Open and valued, CC 129, 133
Operation of, 68 ff.
Opinion in, C 60
Promises in, distinguished from representations, C 65
Representations in, effect of, C 102

Insurance, contracts of, *cont.*:
Risks covered by:
Against loss by fire, CC 86, 89, 92
Against loss of life, CC 94, 96
Statutes, effect of, CC 22 and 133

Subrogation incident to, CC 135, 137
Suicide, effect of, on life policy, C 96
Valued policy, C 133
Vested interest in, C 80
Warranties in:
Distinguished from representation, CC 102, 107
Effect of breach of, CC 102, 105
Effect of materiality on, CC 102, 105
Must be strictly complied with, CC 102, 105
Not found by construction, C 102
What are, CC 102, 105
Who may make, as insured, *see* Insurable Interest
Who may recover on, CC 76, 80, 83
With more than one company, on same property, effect of, C 133
Writing not required, C 22

Labor combinations as affected:
By Clayton Act, C 268
By Sherman Act, C 254
Labor combinations as violation of anti-trust laws, CC 264, 268
Labor problems, as affected by law, 145–278; *see* Table of Contents, Boycott, Employment, Injunction, Strikes, etc.
Labor unions, *see* Labor problems, *supra*
Right of non-union man against, because of being kept from work, C 223
Legislative control of employment relation, 147 ff.

Master and servant, common law of, inadequate, 146, 147
Master's liability for servant's acts, 147
Master's liability to servants, 146, 147; *see* Assumption of risk; Contributory negligence, Fellow-servant rule; Workmen's Compensation Acts; Risks of employment
Misrepresentations, *see* Insurance contracts
Mutuality, effect of want of, on agreement, C 10

Negligence, *see* Master and servant; Workmen's Compensation Acts

Partnership:
Acts of members binding on all members of, when, CC 524, 529, 531, 534
Association not, when, C 288
Basis of, C 337, 340
By estoppel, C 363
Control of, how distributed, C 503
Created how, CC 284, 288, 337, 340, 363
Creditors' rights against, 589, 590, 592
Debts of, property available to satisfy, CC 589, 590, 592
Dissolution, distribution of property upon, C 625
Effect of, general, C 534
On liability of member, C 623
Effected how, C 619
Notice of, C 619
Rights of members upon, C 625
Distribution of assets on dissolution, C 625, C 299
Duty of members to each other, CC 305, 567
Effect on, of death of member, C 299
Formation, CC 284, 288, 337, 340
General powers of, C 524
Liability of members of, for debts of, C 308
Limitations of powers of, C 289
Limited, C 289
Majority powers, C 467
Members of, fiduciary relation of, to each other, C 330
Members of, liability of, as affected by dissolution, C 623
Liability of, for acts of other members, when, CC 524, 529, 531, 534
Power to enrich selves, at expense of firm, C 567
Responsibility of, for debts of firm, CC 589, 590, 592
Rights of, C 592
Minority powers, C 467
Powers of, CC 295, 297
Properity of, what is, C 369
Responsibility of, for torts, C 582
Rights of members as to each other, C 305
Rights of members in management, C 503
Sale of goods to, by one member of, C 330
Share of members in management of, C 467
Transfer of share in, effect of, C 297

Partnership, *cont.*:
Who has title to property of, CC 297, 299
Who responsible for debts of, CC 589, 590, 592
Property rights protected by the constitution, CC 154, 159

Risks, *see* Table of Contents
Classified, 3
Contracts for shifting, distinguished from gambling contracts, 5
Contracts sole legal device for shifting, 8
Defined, 3, 5
Devices for shifting, considered, CC 10 ff.
Soundness of policy of shifting, 5–8
Risks of employment
As affected by modern legislation, CC 190, 204–14
Assumed by employee at common law, CC 164, 165, 172, 177, 178
Not assumed by employee at common law, CC 150, 181, 182, 186

Safe equipment, what is, C 183 *see* Employment
Sherman Act, effect of, on labor combinations, C 264

Speculative contracts, distinguished from gambling contracts, CC 13, 15, 18
Statutory changes necessary as to master and servant relations, 146
Stock, *see* Corporations
Stockholders, *see* Corporations
Strikes:
By men under contract, C 250
Illegal means to effect, does not make whole strike bad, C 240
Legality of, C 223, 232
Means used to perpetuate, C 236
Objects of, C 232
Purposes of, lawful and unlawful, CC 223, 232, 236, 240
Sympathetic, CC 240, 268
Subrogation, *see* Insurance, contracts of

Waiver of condition, *see* Insurance
Workmen's Compensation Act;
Accident, what is, under, CC 204, 206, 210, 211, 213, 214
Compensable injuries under, CC 204, 206, 208, 209, 210, 211, 213
Constitutionality of, C 190
Injury, what is, under, CC 204, 206, 208, 209, 210, 211, 213, 214

PRINTED IN THE U.S.A.

Y0-EJN-764